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TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1945

No. 69

LILLIAN BOEHM, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR CERTIORARI FILED MAY 10, 1945.

CERTIORARI GRANTED JUNE 11, 1945.

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1945

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[fol. 1]

BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket No. 111621

LILLIAN BOEHM, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Appearances:

For Taxpayer: Louis Boehm, Esq.
For Comm'r: P. J. Cavanaugh, Esq.

DOCKETT ENTRIES

1942

Jun. 22—Petition received and filed. Taxpayer notified. Fee paid.
Jun. 22—Copy of petition served on General Counsel.
Jun. 22—Request for Circuit hearing in New York filed by taxpayer. 6/22/42 Copy served.
Aug. 10—Answer filed by General Counsel.
Aug. 12—Copy of answer served on taxpayer. (New York City)

1943

Mar. 23—Hearing set June 14, 1943. (New York City)
Jun. 14—Hearing had before Judge Van Fossan on the merits. Submitted.
Stipulation as to the facts filed. Briefs due August 1, 1943.
Reply briefs due August 16, 1943.
[fol. 2] Jun. 26—Transcript of hearing 6/14/43 filed.
Jul. 27—Brief filed by General Counsel. 7/30/43 Copy served
Jul. 30—Brief filed by taxpayer. 7/30/43 Copy served.
Aug. 13—Reply brief filed by General Counsel. Served 8/14/43.
Aug. 14—Reply brief filed by taxpayer. 8/16/43 Copy served.

1943

Oct. 23—Memorandum findings of fact and opinion rendered. Van Fossan, Judge, Div. 9. Decision will be entered under Rule 50. 10/23/43 Copy served.

Nov. 5—Motion for a rehearing to open the record for the presentation and submission of further evidence, filed by taxpayer. 11/8/43 Denied.

Dec. 15—Computation of deficiency filed by General Counsel. Agreed to.

Dec. 18—Decision entered. Van Fossan, Judge, Div. 9.

Dec. 31—Motion to fix amount of bond at $7000.00 filed by taxpayer.

1944

Jan. 8—Motion to fix amount of bond at $9100.00 filed by taxpayer. 1/11/44 granted.

Feb. 16—Bond in the sum of $9100.00 approved and ordered filed. Power attorney and agreement.

Feb. 16—Petition for review by U. S. Circuit Court of Appeals 2nd Circuit, with assignments of error filed by taxpayer.

Feb. 24—Affidavit of service by mail filed.

Feb. 24—Praecipe for record filed by taxpayer.

Feb. 24—Affidavit of service by mail filed.

[fol. 3] UNITED STATES BOARD OF TAX APPEALS

Docket No. 111621

[Same Title]

PETITION

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Collector of Internal Revenue in his notice of deficiency (Bureau symbols C-TS:NYD COP) dated April 21, 1942, and as a basis of his proceeding alleges as follows:

1. The petitioner is an individual with residence at 470 West End Avenue, Borough of Manhattan, City and State of New York. The returns for the periods here involved

were filed with the Collector for the Third District of New York.

2. The notice of deficiency (a copy of which is attached and marked Exhibit "A"), was mailed to the petitioner on April 21, 1942.

3. The taxes in controversy are income taxes for the calendar years 1936 and 1937. The deficiency asserted is $7,663.09, all of which is in controversy.

4. The determination of tax set forth in the said notice of deficiency is based upon the following errors:

A. In including as taxable income for the year 1936 the sum of $500 received as dividends from The Lehman Corporation (Exhibit A, page 3).

B. In including as taxable income for the year 1936 the sum of $46, as the alleged value of the right to subscribe [fol. 4] to $200 principal amount of National Dairy Products Corporation debentures at 23 (Exhibit A, page 3).

C. In including as taxable income for the year 1937 the sum of $100 allegedly received as dividends from Fifth Avenue Coach Company (Exhibit A, page 5).

D. In including as taxable income for the year 1937 the sum of $44.32 received as dividends from Fifth Avenue Coach Company (Exhibit A, page 5).

E. In including as taxable income for the year 1937 the sum of $300 allegedly received as dividends from Loew's, Inc. (Exhibit A, page 5).

F. In including as taxable income for the year 1937 the sum of $480 allegedly received as dividends from National Dairy Products Corporation (Exhibit A, page 5).

G. In including as taxable income for the year 1937 the sum of $1,250 received as dividends from The Lehman Corporation (Exhibit A, page 5).

H. In including as taxable income for the year 1937 the sum of $250 received as dividends from American Canadian Properties Corp. (Exhibit A, page 5).

I. In including as taxable income for the year 1937 the sum of $12,500 received upon the sale of stock of The Hartman Corporation (Exhibit A, page 6).

J. In disallowing a deduction for the year 1937 of $19,940 as a loss on stock of The Hartman Corporation (Exhibit A, page 6).

K. In including as taxable income for the year 1937 of the sum of $4,612 received upon the sale of stock of Spear & Company (Exhibit A, page 7).

5. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

[fol. 5] A

I. Upon information and belief, that The Lehman Corporation was duly organized under the laws of the State of Delaware on or about September 14, 1929.

II. Upon information and belief, that The Lehman Corporation files its income tax returns on a fiscal year basis, ending June 30th in each and every year.

III. Upon information and belief, that the earnings or profits of The Lehman Corporation accumulated after February 28, 1913 were as follows:

Period	Profit or (Loss)
September 24, 1929 to December 31, 1934	($16,264,941.51)
January 1, 1935 to June 30, 1935	1,299,149.39
Sub-total to June 30, 1935	($14,965,792.12)
July 1, 1935 to December 31, 1935	3,295,603.75
Sub-total to December 30, 1935	($11,670,188.37)
January 1, 1936 to June 30, 1936	7,040,933.07
Sub-total to June 30, 1936	($4,629,255.30)
June 30, 1936 to December 31, 1936	5,474,270.55
Sub-total to December 31, 1936	845,015.25
January 1, 1937 to June 30, 1937	7,023,068.77
	$7,868,084.02
July 1, 1937 to December 30, 1937	1,849,050.97
Total December 30, 1937	$9,717,134.99

[fol. 6] IV. Upon information and belief, that at all of the several times when the foregoing operating losses were sustained by The Lehman Corporation, it had a large paid-in surplus (no part of which resulted from transfers of earnings) in excess of said operating losses.

V. That in the year 1936 there was paid to petitioner the sum of $500 as dividends by The Lehman Corporation.

VI. Upon information and belief, that on December 31, 1935, the Lehman Corporation had an accumulated operating deficit of $11,670,188.37; that said Corporation's earnings for the calendar year 1936 totalled $12,315,203.62, leaving a balance over and above the accumulated operating deficit that existed on December 31, 1935 of $845,015.25; that during the calendar year 1936 said Corporation paid dividends aggregating $2,627,695.00, of which only 32% was paid out of income, for which reason only that percentage of the dividends received by petitioner is taxable.

B

I. Upon information and belief, petitioner did not sell or exercise the right to subscribe to debentures of National Dairy Products Corporation.

C

I. That petitioner during the year 1937 received $316 as dividends from Fifth Avenue Coach Company.

II. That petitioner's records show the receipt of only $316 as dividends from Fifth Avenue Coach Company.

[fol. 7] III. That during the year 1937 petitioner was the owner of 158 shares of capital stock of Fifth Avenue Coach Company.

IV. That in response to an inquiry made on behalf of petitioner, said Fifth Avenue Coach Company advised that the dividends paid during the year 1937 amounted to $2 a share.

V. That the amount of $416 allegedly reported by Fifth Avenue Coach Company on form F-1099 as having been paid to petitioner during the year 1937 as dividends, was reported in error.

D

I. That during the year 1937 petitioner exchanged her shares of stock of New York Transportation Company for stock of Fifth Avenue Coach Company.

II. That prior to 1937 all the issued and outstanding stock of Fifth Avenue Coach Company was owned by New York Transportation Company.

III. That during the year 1937 New York Transportation Company was dissolved and the stock of Fifth Avenue Coach Company distributed to its stockholders.

IV. That in connection with said dissolution, petitioner on March 30, 1937 received the sum of $44.32, which was a capital distribution, and not income.

E

I. That petitioner during the year 1937 received $600 as dividends from Loew's, Inc.

[fol. 8] II. That petitioner's records show the receipt of only $600 as dividends from Loew's, Inc.

III. That petitioner endorsed a check for $300, being part of the said $600, to her brokers for deposit in her account.

IV. That said brokers erroneously recorded said deposit as a dividend received by petitioner, resulting in a duplication of $300 of the $600 received by petitioner.

F

I. That petitioner during the year 1937 received $240 as dividends from National Dairy Products Corporation.

II. That petitioner's records show the receipt of only $240 as dividends from National Dairy Products Corporation.

III. That petitioner's brokers erroneously credited certain dividends paid by National Dairy Products Corporation to petitioner instead of to petitioner's husband Louis Boehm, who was entitled to receive the same, and who reported the same as income in his return filed for the year 1937.

G

I. Petitioner repeats the allegations set forth in Paragraph 5, subdivision A, sub-paragraphs I to IV, inclusive, with the same force and effect as though set forth at length hereunder (Pages 3 and 4).

II. In the year 1937 there was paid to petitioner the sum of $1,250 as dividends by The Lehman Corporation.

[fol. 9] III. That during the year 1937 the earnings of The Lehman Corporation totalled $8,872,119.74; the dividends paid by said corporation during said year aggregated $9,790,167.00, of which only 89% was paid out of income, for which reason only that percentage of the dividends received by petitioner is taxable.

H

I. That petitioner during the year 1937 received $250 as dividends from American Canadian Properties Corp.

II. Upon information and belief, said $250 was a capital distribution, not taxable as income.

III. That petitioner was informed by American Canadian Properties Corp. that the said dividend was a capital distribution, the funds for which were derived from the sale of certain properties of the Company.

I

I. Petitioner purchased 1100 shares of Hartman Corporation, Class A stock in 1929 at a cost of $32,440.00.

II. Upon information and belief that said Hartman Corporation was mismanaged by its directors, who wasted and diverted its assets.

III. That in 1932 petitioner and other stockholders of Hartman Corporation commenced an action on behalf of the Hartman Corporation against its former directors, to recover for waste, mismanagement and diversion of its assets.

[fol. 10] IV. That in 1937 the said action was settled as a result of which petitioner sold her stock and received the sum of $12,500.

V. That by reason of the foregoing, petitioner sustained a loss of $19,940 in the year 1937, when the aforesaid cause of action, which constituted a valuable property right of the Hartman Corporation, was settled.

J

I. Petitioner repeats the allegations set forth in Paragraph 5, subdivision I, sub-paragraphs I to V, inclusive, with the same force and effect as though set forth at length hereunder (Page 8).

K

I. Petitioner purchased 190 shares of Spear & Company common stock in 1929 at a cost of $1848.

II. Upon information and belief, that said Spear & Company was mismanaged by its directors, who wasted and diverted its assets.

III. That in 1934 petitioner commenced an action on behalf of Spear & Company against its directors, to recover for waste, mismanagement and diversion of assets.

IV. That in 1937 said action was discontinued when petitioner sold her stock for $6,460.

V. That by reason of the foregoing petitioner sustained a capital gain of $4,612.

[fol. 11] Wherefor, the petitioner prays that this Board may hear the proceeding, and

(a) delete the increase of income for the year 1936 by $500 representing dividends received from The Lehman Corporation;

(b) delete the increase of income for the year 1936 by $46 representing the value of the right to subscribe to National Dairy Products Corporation debentures:

(c) delete the increase of income for the year 1937 by $100 allegedly received as dividends from Fifth Avenue Coach Company:

(d) delete the increase of income for the year 1937 by $44.32 received as dividends from Fifth Avenue Coach Company;

(e) delete the increase of income for the year 1937 by $300 allegedly received as dividends from Loew's, Inc.;

(f) delete the increase of income for the year 1937 by $480 allegedly received as dividends from National Dairy Products Corporation;

(g) delete the increase of income for the year 1937 by $1,250 received as dividends from The Lehman Corporation;

(h) delete the increase of income for the year 1937 by $250 received as dividends from American Canadian Properties Corp.;

(i) delete the increase of income for the year 1937 by $12,500 received upon the sale of stock of The Hartman Corporation;

(j) allow the deduction for the year 1937 of $19,940 as a loss on stock of The Hartman Corporation;

[fol. 12] (k) delete the increase of income for the year 1937 by $4,612 received upon the sale of stock of Spear & Company;

(l) grant to petitioner such other, further and different relief as to this Board may seem just and proper.

Dated, New York, June 19th, 1942.

Lillian Boehm, Petitioner, 60 Broad Street, New York City.

Louis Boehm, Counsel.

(Verified by Lillian Boehm on June 19, 1942.)

[fol. 13] EXHIBIT "A," ANNEXED TO PETITION

Treasury Department

Internal Revenue Service

Office of
Internal Revenue Agent
in Charge
Upper New York Division

Apr 21 1942

Mrs. Lillian Boehm,
470 West End Avenue,
New York, New York.

Madam:

You are advised that the determination of your income tax liability for the taxable years 1936 and 1937 discloses a deficiency of $7,663.09 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to Internal Revenue Agent in Charge, 341-9th Ave., New York, N. Y. for the attention of UNY:CONF:EAC. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency, and will prevent the accumulation of interest, since the interest [fol. 14] period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully, Guy T. Helvering, Commissioner; by
C. B. Allen, Internal Revenue Agent in Charge.

Enclosures: Statement. Form of waiver.

STATEMENT

Mrs. Lillian Boehm
470 West End Avenue
New York, New York

Tax Liability for the Taxable Years Ended December 31, 1936 and 1937

Income Tax

Year	Liability	Assessed	Deficiency
1936	$ 208.32	$ 82.69	$ 125.63
1937	7,691.14	153.68	7,537.46
Totals	$7,899.46	$236.37	$7,663.09

In making this determination of your income tax liability, careful consideration has been given to the report of examination dated January 31, 1938, November 30, 1939; to your protest dated March 25, 1940; and to the statements made at the conferences held on May 29, 1940, June 14, 1940, September 17, 1941, and October 3rd, 1941.

If you do not acquiesce in all of the adjustments making up the deficiency indicated, but desire to stop the accumulation of interest on that part of the deficiency resulting from adjustments to which you agree, please fill out the enclosed form of waiver, inserting therein the [fol. 15] amount of the deficiency you desire to have assessed at once. The execution of the form for the agreed portion of the deficiency will not deprive you of your right to petition the United States Board of Tax Appeals for a redetermination of the deficiency.

Taxable Year Ended December 31, 1936

Adjustments to Net Income

Net income as disclosed by return		$2,449.63
Unallowable deductions and additional income:		
(a) Interest	$1,990.00	
(b) Interest (tax-free covenant bonds)	600.00	
(c) Dividends	746.00	3,336.00
Total		$5,785.63

Non-taxable income and additional deductions:	
(d) Capital gain	812.99
Net income adjusted	$4,972.64

Explanation of Adjustments

(a) Interest received on securities	$7,984.63
Interest reported on securities	5,994.63
Increase	$1,990.00
(b) Interest received (tax-free covenant bonds)	$875.00
Interest reported (tax free covenant bonds)	275.00
Increase	$600.00

[fol. 16] The above adjustments, which are not in dispute have been explained in detail in statements previously furnished you.

(c) The taxable income from dividends reported in your 1936 return was understated by the sum of $746.00 received from the following named corporations:

Lehman Corporation	$500.00
National Dairy Products Corporation	46.00
Safeway Stores, Inc.	200.00
Total	$746.00

(d) Capital gains:	
As reported	$1,269.95
As corrected	456.96
Decrease	$812.99

This adjustment, which is not in dispute, has been explained in detail in statements previously furnished you.

Computation of Tax

Net income adjusted	$4,972.64
Less:	
Personal exemption	None
Credit for dependents	None
Balance (surtax net income)	$4,972.64

Less:	
Earned income credit (10% of $3,000.00)	300.00
Net income subject to normal tax	$4,672.64

[fol. 17]

Normal tax at 4% on $4,672.64	$186.91
Surtax on $4,972.64	38.91
Total tax	$225.82
Less:	
Income tax paid at source	17.50
Correct income tax liability	$208.32
Income tax assessed:	
Original, Account No. 828189	82.69
Deficiency of income tax	$125.63

Taxable Year Ended December 31, 1937

Adjustments to Net Income

Net income as disclosed by return		$7,822.41
Unallowable deductions and additional income:		
(a) Dividends	$2,035.91	
(b) Worthless stock	19,940.00	
(c) Settlement of suit	12,500.00	
(d) Settlement of suit	4,612.00	
(e) Interest	26.61	39,114.52
Net income adjusted		$46,936.93

Explanation of Adjustments

(a) The taxable income from dividends reported in your 1937 return was understated by the sum of $2,035.91, determined as follows:

Taxable dividends received in 1937	$19,821.19
Taxable dividends reported in your 1937 return	17,785.28
Understatement	$2,035.91

[fol. 18] (b) The amount of $19,940.00 claimed in your 1937 return as a loss on worthless stock of the Hartman Corporation does not represent an allowable deduction from gross income for that year under the provisions of Section 23 of the Revenue Act of 1936.

(c) It is held that the amount of $12,500, received by you in 1937 as the result of the settlement of an action brought against former directors of the Hartman Corporation, represents taxable income for that year which was not reported as such in your 1937 return.

(d) It is held that the amount of $4,612.00, received by you in 1937 as a result of the settlement of an action brought against the directors of Spear & Company represents ordinary income rather than capital gain as reported in your 1937 return.

(e)

Interest received—per return—lines 3 and 4	$8,084.74
Interest received—corrected	8,111.35
Increase	$26.61

This adjustment, which is not in dispute, has been explained in detail in statements previously furnished you.

Computation of Tax

Net income adjusted		$46,936.93
Less:		
Personal exemption	$2,500.00	
Credit for dependents	800.00	3,300.00
Balance (surtax net income)		$43,636.93
[fol. 19] Less:		
Earned income credit (10% of $3,000.00)		300.00
Net income subject to normal tax		$43,336.93
Normal tax at 4% on $43,336.93		$1,733.48
Surtax on $43,636.93		5,992.86
Total Tax		$7,726.34

Less:	
Income tax paid at source	35.20
Correct income tax liability	$7,691.14
Income tax assessed:	
Original, Account #265,001	153.68
Deficiency of income tax	$7,537.46

[fol. 20] UNITED STATES BOARD OF TAX APPEALS

Docket No. 111621

[Same Title]

ANSWER

Comes now the respondent, by his attorney, J. P. Wenchel, Chief Counsel for the Bureau of Internal Revenue, and for answer to the petition heretofore filed in this proceeding, admits and denies as follows:

1. Admits the allegations in paragraph 1 of the petition.

2. Admits the allegations in paragraph 2 of the petition.

3. Admits the allegations in paragraph 3 of the petition.

4. Denies that respondent erred in any respect as alleged in paragraphs 4, A to K, inclusive.

5. A. I to IV, inclusive. Denies the allegations in paragraphs 5. A. I to IV, inclusive.

5. A. V. Admits the allegations in paragraph 5. A. V.

5. A. VI. Denies the allegations in paragraph 5. A. VI.

5. B. I. Denies as immaterial the allegations in paragraph 5. B. I. of the petition.

5. C. I to V., inclusive. For lack of sufficient information, cannot admit and therefore denies the allegations in the [fol. 21] correspondingly numbered and designated paragraphs of the petition.

5. D. I to IV, inclusive. Denies the allegations in the correspondingly numbered and designated paragraphs of the petition.

5. E. I to IV, inclusive. For lack of sufficient information cannot admit and therefore denies the corespondingly numbered and designated paragraphs of the petition.

5. F. I to III, inclusive. Denies all and singularly the allegations in the correspondingly numbered and designated paragraphs of the petition.

5. G. I to III, inclusive. Denies all and singularly the allegations in the correspondingly numbered and designated paragraphs of the petition.

5. H. I to III, inclusive. Denies all and singularly the allegations in the correspondingly numbered and designated paragraphs of the petition.

5. I. I to V, inclusive. Denies all and singularly the allegations in the correspondingly numbered and designated paragraphs of the petition.

5. J. I. Denies all and singularly the allegations in the correspondingly numbered and designated paragraph of the petition.

5. K. I to V, inclusive. Denies all and singularly the allegations in the correspondingly numbered and designated paragraphs of the petition.

[fol. 22] 6. Denies generally and specifically each and every material allegation in the petition not herein admitted, qualified, or denied.

WHEREFORE, it is prayed that the determination of the Commissioner be approved and that the relief prayed for by petitioner be denied.

(Signed) J. P. Wenchel, RPH, Chief Counsel, Bureau of Internal Revenue.

Of Counsel: E. C. Algire, Division Counsel; J. R. Johnston, Special Attorney, Bureau of Internal Revenue.

[fol. 23] THE TAX COURT OF THE UNITED STATES

Docket No. 111621

[Same Title]

MOTION FOR A REHEARING TO OPEN THE RECORD FOR THE PRESENTATION AND SUBMISSION OF FURTHER EVIDENCE

Comes now the petitioner by her attorney, Louis Boehm, and respectfully shows to the Court:

This case was on the calendar of this Court on June 14, 1943, at which time it was submitted upon a stipulation of facts. At the time of the preparation and submission of the stipulation of facts, counsel for both parties intended to include all the facts necessary for a determination of the issues in the case.

On October 23, 1943, this Court in an opinion by Judge Van Fossan decided that the stipulation did not contain sufficient facts to enable it to decide the issues on the merits. As appears from the opinion of this Court, there were two issues in this case:

The first issue presented "the question of when the petitioner's stock in Hartman (Virginia) became worthless" (opinion, p. 7). Petitioner contended that "the identifiable event which determined the fact and the extent of her loss due to the worthlessness of the stock was the negotiated settlement of the Graham suit in 1937 * * *" (Opinion, p. 8). This Court in its opinion said: "We have no evidence on which to base a conclusion that the Graham suit was an asset of any substantial value. We know nothing of the merits of the suit, the probability of recovery, the assurance of the collection of a judgment, or other essential factors. The stipulated fact that the defendants were men of financial responsibility is not [fol. 24] sufficient to establish the collectibility of a recovery equal to the outstanding claims. These claims aggregated more than half a million dollars and had to be satisfied before there would be anything for the stockholders."

The stipulation of facts included a copy of the complaint in the Graham suit as Exhibit 6-F. When we prepared the stipulation we were of the opinion that the facts

set forth in the complaint, plus the fact that the defendants had paid out $50,000 in settlement of their liability, sufficiently disclosed the fact that the action was a meritorious one, and that there was a probability of recovery against the directors. Apparently we were mistaken in that opinion. The omission was entirely inadvertent, and can readily be supplied. This motion is made for the purpose of enabling the petitioner to supply this evidence, either by a further stipulation of facts, or by the testimony of witnesses familiar with the Graham case, who will testify as to the facts upon which the suit was based, the merits of the suit, the probability of recovery therein, and the collectibility of a judgment against the directors. Paragraph "15" of the complaint in the Graham suit alleged that in the years 1929 and 1930 the directors purchased 64,879 shares of Hartman Corporation Class B stock in the open market at a cost of $1,422,000. It is further alleged in Paragraph "18" of the complaint that part of the stock so purchased by the Corporation was stock owned by the directors, and that they personally benefitted thereby. The entire amount of $1,422,000 paid for this stock became a total loss to the Hartman Corporation. Quite apart from the other allegations of damage set forth in the complaint, this claim alone of $1,422,000 is more than twice the amount of the outstanding claims of $707,-[fol. 25] 000, mentioned at page 8 of the opinion of this Court. Evidence will be offered on the rehearing to show that the recovery on the causes of action set forth in the complaint would far exceed the amount of outstanding claims of creditors, and would leave a substantial amount for the stockholders. Evidence will also be offered that the defendant directors in the Graham suit were able to respond to any judgment that might be rendered against them, and that their net worth was many millions of dollars.

The second issue in this case is whether "the payment of $12,500 was income to petitioner" (Opinion, p. 8). This amount was received by petitioner as her share of the settlement in the Graham suit. This Court in its opinion at page 9 stated: "How the sum was arrived at we do not know. Apparently it was a negotiated lump-sum settlement. Whether the defendants merely 'bought their peace' we can only conjecture." This motion is made to enable

petitioner to offer proof that the directors did not merely "buy their peace," but that it was the result of an approximate admeasurement of the damage which was suffered by the plaintiff stockholders in the Graham suit, as a result of the mismanagement of the corporation by the directors, which resulted in its insolvency. This proof will be supplied by witnesses who engaged in the negotiations which led to the settlement, and who will testify as to how the amount was arrived at, and that the settlement was not based on the nuisance value of the suit, but that it was intended to compensate the stockholders for their proportionate loss occasioned by the wrongful acts of the directors.

Unless this further evidence is supplied on a rehearing, the decision in this case will not be upon the merits. The stipulation of facts was prepared for the convenience of the Court, and to eliminate the necessity of deciding [fol. 26] factual issues concerning which there was no dispute. In endeavoring to expedite the administration of justice in this controversy, the parties inadvertently failed to supply evidence which this Court upon a careful study of the case deemed to be necessary to a proper determination of the issues on the merits. Petitioner should not be prejudiced by this inadvertent omission. Petitioner and her counsel believe that the further evidence will result in a decision of both issues on the merits, instead of a decision based upon the inadvertent omission of necessary facts in the stipulation. For that reason, the granting of the within motion will be in the interest of substantial justice.

Premises considered, petitioner moves and prays:

That the motion for a rehearing be granted, and that petitioner be afforded an opportunity on rehearing to produce evidence as to the merits of the Graham suit, the probability of recovery therein, the collectibility of a judgment rendered therein, and that the settlement of the Graham suit was intended to compensate the petitioner for the damage suffered by her by reason of the acts complained of in the Graham suit.

Louis Boehm, Counsel for Petitioner, 60 Broad Street, New York, N. Y.

[fol. 27] THE TAX COURT OF THE UNITED STATES

[Same Title]

STIPULATION OF FACTS

It is hereby stipulated and agreed, by and between the parties hereto, by their respective counsel, that the following facts shall be taken as true and correct; provided, however, that this stipulation shall be without prejudice to the right of either party to introduce other and further evidence not inconsistent with the facts herein stipulated.

1. Petitioner is a married individual residing in New York, New York. Her separate income tax return for the year 1937 was filed with the Collector of Internal Revenue for the Third District of New York.

2. In 1929 the petitioner purchased 1,100 shares of the Class "A" stock of The Hartman Corporation at a cost of $32,440.00. The Hartman Corporation was incorporated in 1916 in the State of Virginia to acquire the capital stock of the Hartman Furniture and Carpet Company, an Illinois corporation, and its affiliates, engaged in the business of selling furniture, carpets and household goods.

3. In June 1932 Martin L. Straus and Elias Mayer were appointed equity receivers for The Hartman Corporation in the District Court of the United States for the Northern District of Illinois, Eastern Division. The said receivers entered into possession of the company's property and continued its business of buying and selling furniture and other household articles from the time of their appointment until on or about May 26, 1933. Copies of the bill of complaint in such action and the order appointing [fol. 28] the receivers are attached hereto and made a part hereof as Exhibits 1-A and 2-B.

4. Petitioner received a letter from The Hartman Corporation dated April 4, 1932 with balance sheet of December 31, 1931, copy of which is attached as Exhibit 3-C and made a part hereof, and on May 4, 1932 received a letter from the same company, copy of which is attached as Exhibit 4-D and made a part hereof.

5. In 1933 a new corporation called Hartman's, Inc., was organized under the laws of the State of Delaware.

As of May 26, 1933 Hartman's, Inc., purchased at a bankruptcy sale the assets of Hartman Furniture and Carpet Company (Illinois) the wholly-owned subsidiary of The Hartman Corporation for the sum of $501,000.00 in cash and an agreement to procure a waiver of certain intercompany claims against the bankrupt estate. The stock of the new company was issued to the creditors of Hartman Furniture and Carpet Company (Illinois) in settlement of claims, and to the stockholders of The Hartman Corporation by subscription thereto. The stockholders of The Hartman Corporation were given the right to subscribe for debentures and capital stock of Hartman's, Inc., as set forth in letter dated June 7, 1933, attached hereto as Exhibit 5-E and made a part hereof.

6. The petitioner did not exercise the right of subscribing to the debentures and stock of Hartman's, Inc., and did not acquire any interest in that company in 1933 or thereafter.

7. The receivers of the Hartman Corporation filed a report with the Court on August 10, 1934. The assets on that date were there said to consist of $39,593.13 in cash [fol. 29] and a suit pending against the directors of The Hartman Corporation in New York, being the same suit hereinafter referred to in paragraph 10 hereof. There were total claims outstanding of $707,430.67. The receivers recommended that claims totaling $630,574.57 be allowed. The Court approved this report by an order dated August 10, 1934. It also awarded $3,500.00 as compensation to each of the receivers and $5,000.00 as attorneys' fees. The receivers filed a second report on July 11, 1935. Assets were cash in the amount of $27,192.51 and the pending suit against the directors. Liabilities remained the same. The receivers recommended that a dividend of four per cent be paid on the claims totaling $630,574.57 and that one of $176,856.10 be disallowed by order of the Court. The Court, by order dated June 11, 1934, adopted the report and its recommendations. One of the two receivors was released from further duties on August 26, 1935. The suit against the directors was dismissed on May 14, 1937 according to stipulation filed.

8. The remaining receiver filed a final report with the Court on September 30, 1937. The sole remaining asset

was cash in the amount of $1,909.94. Claims totaled $630,574.57. It was recommended that compensation totaling $900.00 be allowed the receiver and counsel and the remainder be distributed to the creditors. The Court adopted the recommendations and discharged the receiver by an order dated September 30, 1937.

9. Petitioner in her Federal income tax return for the year 1934 claimed a deduction from gross income in the amount of $32,302.00 as a loss due to the worthlessness of the 1,100 shares of the Class "A" stock of The Hartman Corporation owned by her. Said deduction was denied by the respondent on the ground that said stock did not become worthless in the year 1934.

[fol. 30] 10. On December 16, 1932 petitioner with other stockholders of The Hartman Corporation commenced an action in the Supreme Court of the State of New York, County of New York, in behalf of The Hartman Corporation, against its former officers and directors. Copies of the summons and complaint in such action are attached hereto as Exhibit 6-F. That thereafter during the years 1933 to 1936, inclusive, and in connection with the prosecution of said action, petitioner's counsel went to Chicago, Illinois, and spent four days there on the examination of certain of the defendants who resided in that City. That examinations of certain of the defendants were also held from time to time in the City of New York. That in the course of such examinations many hundreds of pages of testimony were taken and numerous exhibits were offered in evidence. Petitioner and other plaintiff stockholders were ordered by the New York Supreme Court to pay the counsel fees and transportation and hotel expenses of the defendants' New York counsel who traveled to Chicago and represented said defendants on such examination. Such counsel fees and expenses amounted to approximately $800.00. That petitioner and the other plaintiff stockholders also paid the transportation and hotel expenses of their own counsel in attending upon such examinations and also paid the fees of the stenographer who took down in shorthand and transcribed the testimony of such defendants and also paid the fees of the commissioner before whom the examinations were held. Petitioner and other plaintiff stockholders also paid for the cost of print-

ing the briefs in the Appellate Division of the New York Supreme Court on an appeal which defendants had taken to such Court. That the amount of disbursements incurred and paid by petitioner and the other plaintiff stockholders, exclusive of the fees of their own counsel, amounted to ap- [fol. 31] proximately $2,000.00. That at the conclusion of such examinations and shortly before the trial, negotiations were commenced for a settlement of the action. That on February 20, 1937 said negotiations were consummated in a settlement as a result of which the defendant directors paid to petitioner and the other plaintiff stockholders the sum of $50,000.00 in full settlement and discharge of the claims and cause of action of petitioner and the other plaintiff stockholders as set forth in the complaint in the action above referred to. That petitioner and the other stockholders in connection with the aforesaid settlement released all their rights and claims arising out of the acts committed by the defendants as set forth in their complaint. That other than the cause of action set forth in said complaint The Hartman Corporation at the time of the settlement had no other assets except the sum of $1,909.94 in cash, as above set forth, against which claims of creditors had been allowed by the Court in the sum of $630,574.57. Out of the sum of $50,000.00 paid to petitioner and the other stockholders, petitioner received as her proportionate share of the recovery, after the payment of counsel fees and expenses, the sum of $12,- 500.00. That the defendant directors were persons of financial responsibility, some of them being members of the banking firm of Hallgarten and Company, investment bankers of New York and Chicago, one of them being president and director of the May Department Stores, and one being president, director, and principal stockholder of The Advance Corporation which owned a majority of the stock of the Eversharp Pencil Company.

11. Petitioner in her Federal income tax return for the year 1937 claimed a deduction from gross income in the amount of $19,940.00 as a loss due to the worthlessness of the stock of The Hartman Corporation. In the deficiency notice the respondent denied the deduction of $19,- [fol. 32] 940.00 and included the amount of $12,500.00 received upon the settlement in the petitioner's gross income for the year 1937.

12. Petitioner at no time received any deduction from her gross income in the determination of her income tax liability by reason of her investment in said stock.

IT IS FURTHER STIPULATED that the following issues presented in this proceeding shall be disposed of as follows:

13. Respondent concedes that the amount of dividends received in the year 1936 from the Lehman Corporation, as shown in the deficiency notice, is overstated by the amount of $150.00. Petitioner abandons the assignment of error, paragraph 4A of the petition, as to the remainder thereof.

14. Respondent admits error in including as taxable income for the year 1936 the sum of $46.00, paragraph 4B of the petition; and in including as taxable income for the year 1937 the sums of $300.00, paragraph 4-E; $480.00, paragraph 4F; $250.00, paragraph 4H; and $4,612.00, paragraph 4K of the petition, such amount being correctly reported as capital gain in the petitioner's return.

15. Petitioner abandons the assignment of errors set forth in paragraphs 4C, 4D, and 4G of the petition.

Louis Boehm, Counsel for Petitioner; J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue.

[fol. 33] EXHIBIT 1-A, ANNEXED TO FOREGOING STIPULATION OF FACTS

IN THE DISTRICT COURT OF THE UNITED STATES FOR THE NORTHERN DISTRICT OF ILLINOIS, EASTERN DIVISION

In Equity No. 11961

MILON STONE, Plaintiff,

vs.

THE HARTMAN CORPORATION, a Corporation, Defendant

To the Honorable Judges of the District Court of the United States for the Northern District of Illinois, Eastern Division, in Equity Sitting:

The plaintiff herein, Milon Stone, brings this bill of complaint against the defendant, the Hartman Corporation, a

corporation, on his own behalf and on behalf of all other creditors of the defendant who may join in the prosecution of this suit, and alleges as follows:

1. The plaintiff, Milon Stone, is a resident and citizen of the City of Chicago, State of Illinois, and Northern District of Illinois.

2. The defendant, The Hartman Corporation, is a corporation organized and existing under the laws of the State of Virginia, and is a citizen and resident of said state, with [fol. 34] an office in the City of Richmond, in said State of Virginia, and has and maintains an office for the transaction of business and transacts and does business in the City of Chicago, County of Cook, in the State of Illinois, at which office in said City of Chicago its principal books and records are kept, and its principal and executive officers have their offices, and the business of said defendant is principally transacted and all its property and assets are located in said City of Chicago, in the State of Illinois, and in the Eastern Division of the Northern District of Illinois.

3. This is a suit of a civil nature in equity, and the matters in dispute and controversy herein, exclusive of interest and costs, exceed the sum of $3,000.00.

4. The plaintiff is informed and believes, and on such information and belief so states the fact to be, that the defendant was incorporated on, to-wit, the 21st day of January, 1916, and that its outstanding capital stock at the present time consists of 59,072 shares of Class "A" stock and 335,121 shares of Class "B" stock. The shares of Class "A" stock are entitled to cumulative dividends at the rate of $2.00 per share per annum, and no more, payable in preference to dividends under Class "B" stock, and redeemable at $30.00 per share and accrued dividends. Upon the dissolution of the corporation the Class "A" stock is entitled to share equally and ratably with Class "B" shares in the distribution of the assets until the holder of each share of Class "A" stock shall have received $30.00 per share plus accrued dividends. The shares of Class "B" stock have a stated value of $10.00 a share, and are entitled to dividends only after cumulative dividends at the rate of $2.00 per share per annum have been paid on Class "A" [fol. 35] stock, and said Class "B" stock is entitled to share equally with Class "A" stock in the distribution of the

assets of the corporation until Class "A" stock shall have received $30.00 per share and accrued dividends, and thereafter all assets of said corporation are to be distributed ratably among the holders of Class "B" stock without participation with the holders of Class "A" stock.

5. The defendant is engaged through subsidiary companies in conducting stores and places of business for the sale of furniture, carpets, rugs, draperies and other kinds of goods, wares and merchandise in the City of Chicago and other cities in Cook County and other places in the State of Illinois and in various towns and cities in the States of Wisconsin, Indiana and Nebraska, respectively, and said defendant company owns the entire capital stock of said subsidiary companies (except a few qualifying shares in each of said companies), and as such owner of substantially all of the capital stocks of said respective subsidiary companies the defendant company has been obliged from time to time to make provision for the necessary financing of said subs diary companies to enable said subsidiary companies to continue their business, and thereby the defendant compa iy has incurred large financial obligations as a guarantor of notes and other evidences of indebtedness of said subsidiary companies.

6. The plaintiff is informed and believes, and on such information and belief alleges that the said defendant, The Hartman Corporation, now owns and holds (except for qualifying directors shares) all of the capital stock of the following subsidiary corporations:

(a) Hartman Furniture & Carpet Company, an Illinois corporation, with an authorized and outstanding capital [fol. 36] stock of $60,000 operating and conducting stores and places of business in Chicago and other cities in Cook County and in other places in the State of Illinois, and in various towns and cities in the States of Indiana, Wisconsin, and Nebraska, respectively. Said company has assets, exclusive of good will, of approximately $9,500,000 and liabilities of approximately $4,600,000. Said company is the principal operating subsidiary corporation of the defendant corporation.

(b) Hartman's Inc. (formerly known as Hartman Furniture & Carpet Company of Wisconsin), a corporation organized under the laws of the State of Wisconsin, with

an authorized and outstanding capital stock of $50,000; operating and conducting two stores in the City of Milwaukee, and one store at West Allis, a suburb of Milwaukee, in the State of Wisconsin. Said company has assets (including accounts due from the Hartman Furniture & Carpet Company, of Illinois, of $372,907.88) amounting to the sum of $1,086,000, and liabilities in the sum of $55,000.

(c) Hartman Furniture & Carpet Company of Minnesota, a corporation organized under the laws of the State of Minnesota, with an authorized and outstanding capital stock of $30,000, and has assets amounting approximately to the sum of $2500, and has liabilities approximately in the sum of $12,000.

(d) Hartman Furniture & Carpet Company of Nebraska organized under the laws of the State of Nebraska, with an authorized and outstanding capital stock of $60,000. Plaintiff states and alleges on information and belief that the business of this corporation was closed in December, 1931, and that its accounts receivable are pledged to an organization known as the Commercial Investment Trust.

[fol. 37] (e) Illinois Furniture Company (formerly Hartman Furniture & Carpet Company) of Missouri, organized under the laws of the State of Missouri, with an authorized and outstanding capital stock of $10,000. Plaintiff is informed and believes that this company has title to a number of accounts receivable, all of which accounts receivable have been and are pledged with C. I. T. Corporation, a corporation organized and existing under the laws of the State of Maryland.

(f) Hartman Realty Trust, a trust organized under the Massachusetts plan, which holds title to certain warehouse property in the City of Chicago, Illinois. Plaintiff is informed and believes and on said information and belief alleges that this trust issued and caused to be sold $1,250,000 par value of first mortgage 5½% sinking fund gold bonds, of which there are outstanding at the present time $1,009,900. Plaintiff is informed and believes that said property is leased to the Hartman Furniture & Carpet Company, of Illinois, at a rental sufficient to pay all the carrying charges and protect the sinking fund required, and that said lease is pledged as additional security for the payment of said bonds. Plaintiff is further informed and

believes that default has been made in the payment of said sinking fund gold bonds in the sum of approximately $22,000, which was due on the 15th day of February, 1932, and that an additional payment in like amount will fall due on the 15th day of August, 1932.

(g) The 7th and Mitchell Realty Corporation organized under the laws of the State of Wisconsin, with an authorized and outstanding capital stock of 500 shares of no par value, of the declared value of $500.00. Plaintiff is informed and believes and so alleges that said 7th & Mitchell Realty Corporation holds a long term lease on property at 7th and Mitchell Streets, in the City of Milwaukee, State of Wis- [fol. 38] consin, and has an outstanding 6% mortgage bond issue on said lease for the sum of $185,000, of which $177,000 remains outstanding at the present time. Plaintiff is further informed and believes that performance of the terms and conditions of said ground lease by said corporation and the payment of the bonds and interest thereon are unconditionally guaranteed by the defendant company, The Hartman Corporation.

7. Plaintiff is informed and believes, and on such information and belief alleges the fact to be, that on account of the great general business depression that now and for some time last past has prevailed throughout the United States, said defendant company, as the parent company of said subsidiary corporations, and the owner of all of the capital stocks of said subsidiary companies (except certain qualifying shares of directors) has suffered great financial losses through the operation of said stores and places of business and business enterprises of said subsidiary companies, and that the sales of merchandise by said subsidiary corporations so operating and conducting stores and places of business in various locations, as aforesaid, have greatly decreased and are still decreasing, and that unprecedented credit losses have been incurred due to wide-spread unemployment, and that inventory values have greatly declined with the decrease in commodity prices, and that by reason of the general business depression said defendant has been obliged to and has given up and closed a number of stores which have been operated and conducted in various localities by certain of said subsidiary corporations, and that the losses and expenses incurred and sustained by the defendant in closing said stores during the year 1931

amounted to the sum of $761,648.01. The plaintiff is informed and believes, and on such information and belief [fol. 39] alleges that the defendant company, and its said subsidiary companies, during the year 1930, sustained a net loss from the operation of its said stores and places of business in the sum of $1,830,000, and that during the year 1931 the net losses from the operation of said stores and places of business (exclusive of depreciation and amortization on assets written down) amounted to the sum of $2,076,266.39, and that losses resulting from necessary liquidation during the year 1931 amounted to the further sum of approximately $1,150,000, and that since the first of January, 1932, the losses sustained by said defendant and its subsidiaries have amounted to approximately the sum of $400,000, with additional liquidation losses, the exact amount of which is at this time unknown; and the plaintiff is informed and believes, and on such information and belief so states the fact to be, that the business of the defendant and the business of each of said subsidiary corporations, so owned by the defendant, as aforesaid, is being operated at a great financial loss at the present time.

Plaintiff is informed and believes, and on such information and belief alleges that owing to the business depression and the marked decrease in the sales of merchandise and consequent financial loss to the said defendant, the defendant has been obliged to and has closed and discontinued a number of stores, although required to provide for the continued payment of rentals on leases held by its subsidiary companies operating and conducting said stores so closed and discontinued, and in some instances has suffered financial loss by reason of said subsidiary companies being obliged to pay substantial sums of money to obtain releases from further obligation to pay rentals under leases on said closed and discontinued stores.

[fol. 40] 8. Plaintiff is informed and believes, and on such information and belief so states the fact to be, that because of said general business depression the defendant has been and is hindered and delayed in the collection of the claims and indebtedness due to it and to its subsidiaries, and because of the unusual and extreme stringency in the money market the defendant is unable to borrow sufficient funds with which to carry on its business and the business of its subsidiaries and to meet and pay its obligations due and to become due.

9. The defendant is indebted to the plaintiff (after allowing to the defendant all its credits, deductions and set-offs) in the sum of $5,000, which said sum of $5,000 was due and owing to the firm of Haskins & Sells, accountants, for accounting services rendered by the said Haskins & Sells to and on behalf of the said defendant at the defendant's instance and request; that the plaintiff herein is a partner of the co-partnership of Haskins & Sells, accountants, having offices in Chicago, Illinois, and various other cities, and whose partners reside in Chicago, Illinois, and various other cities, not in the State of Virginia that the various partners of said Haskins & Sells have heretofore released and assigned their respective interest in and to the claim of $5,000 against the defendant herein to the plaintiff herein, and the plaintiff has been credited by said firm of Haskins & Sells (as a co-partner therein) with the said sum of $5,000, and the said sum of $5,000 now being due and owing from the said defendant to the plaintiff the said defendant promises immediately to pay to the plaintiff in cash the said sum of $5,000, and payment of said sum has been duly demanded by the plaintiff from the defendant, but the defendant has failed and refused to pay the said sum of $5,000; or any part thereof, and now claims that [fol. 41] it is unable to pay the same at the present time by reason of its financial condition.

10. The plaintiff is informed and believes, and on such information and belief states the fact to be, that the defendant had become and is indebted to a number of creditors and has become and is liable as a guarantor on divers obligations of its said subsidiary companies, which obligations said subsidiary companies are at present unable to meet and pay.

Plaintiff is informed and believes, and on such information and belief so states the fact to be, that during the year last past one of the subsidiary companies of the defendant, to-wit, the Hartman Furniture & Carpet Company, an Illinois corporation, has been largely financed by certain banking and financial houses under a collateral deposit agreement and letter agreement, both dated as of June 30, 1931, between the defendant, The Hartman Corporation, as party of the first part, Hartman Furniture & Carpet Company, as party of the second part, and C. I. T. Corporation, a corporation organized

and existing under the laws of the State of Maryland, and certain other bank corporations, as parties of the third part; that under said collateral deposit agreement and letter agreement the defendant corporation became and is liable as a guarantor for the payment of all notes executed by the Hartman Furniture & Carpet Company, and given to the said banking corporations, for money loaned by said banking corporations to said Hartman Furniture & Carpet Company; and the plaintiff is informed and believes, and on such information and belief so states the fact to be, that the said Hartman Furniture & Carpet Company borrowed large sums of money under said collateral deposit agreement and letter agreement and delivered its notes therefor to said banking corpora-
[fol. 42] tions, and plaintiff is informed and believes, and on such information and belief so states the fact to be, that there is now due and unpaid on notes issued and delivered to said banking corporations under said collateral deposit agreement and letter agreement the total sum of $2,600,000 and that by reason of certain defaults in the terms and provisions of said collateral deposit agreement, said notes may and will be declared due and payable under the terms and provisions of said collateral deposit agreement, whereby the defendant company will become liable for the payment of said $2,600,000 as a guarantor of said notes under said collateral deposit agreement.

The plaintiff is informed and believes, and on such information and belief alleges that the defendant, as the parent corporation, in order to finance Hartman's Inc., of the City of Milwaukee, Wisconsin, and its other subsidiaries, has caused said subsidiary companies to turn over and deliver to the Hartman Furniture & Carpet Company, the Illinois corporation, substantially all of their bills receivable, which bills receivable have been pledged under the aforesaid collateral deposit agreement, the performance of which is guaranteed by the defendant company.

The plaintiff is further informed and believes, and on such information and belief alleges the fact to be, that the performance of the terms and conditions of the ground lease held by the 7th & Mitchell Realty Corporation, on property at 7th & Mitchell Streets, in the City of Milwaukee, Wisconsin, as aforesaid, and also the payment of the 6% mortgage bonds now outstanding in the sum of

$177,000, issued by said realty corporation, are unconditionally guaranteed by said defendant, and that the defendant is therefore liable upon said lease and also liable for the payment of said bonds as a guarantor.

[fol. 43] The plaintiff is further informed and believes, and on such information and belief alleges, that the said defendant company has also guaranteed the performance of the terms and conditions of certain leases of subsidiary companies, to-wit: A certain lease to the Hartman Furniture & Carpet Company, of Illinois, upon the main store at the City of Milwaukee, Wisconsin, operated by Hartman, Inc., the Wisconsin subsidiary corporation, which lease runs for a term ending April 30, 1953, and certain other lease obligations of other subsidiaries, and so far as the plaintiff is informed at the present time, the defendant is also a guarantor of the payment of the bond issue of said Hartman Realty Trust, of which there are outstanding at the present time 5-½ per cent sinking fund gold bonds in the amount of $1,009,900.

11. Plaintiff further alleges on information and belief, that the defendant company, as the owner and holder of all of the capital stocks of the aforesaid subsidiary companies (except qualifying shares of directors) has been at all times actively engaged in controlling and directing the management and business of said subsidiary companies and each of them to the extent that said subsidiary companies are in effect operated as departments of defendant's business; and that creditors of defendant on obligations of the defendant now due or about to become due, and creditors of defendant's subsidiary companies, are pressing their claims for payment, and plaintiff apprehends that they will forthwith bring suits on past due debts, thereby precipitating a race of diligence and a multiplicity of suits, actions, attachments, judgments, executions, levies and seizures by sheriffs, marshals and other like officers, resulting in the disruption of the business of the defendant and the dissipation of its assets and resources [fol. 44] to the great financial loss and damage and irreparable injury of the defendant and its creditors, including the plaintiff; and the plaintiff alleges that any attempt by the plaintiff to enforce at law his claim as a general creditor against defendant would precipitate similar action on the part of other creditors and lead to wasteful

strife and controversy, and that such strife and controversy can be avoided and the property of the defendant preserved for equitable distribution among those entitled thereto only through the intervention of this honorable court as hereinafter prayed.

12. The plaintiff, on information and belief, further alleges that the assets of the defendant and the properties and assets of its subsidiaries are of great value and represent a large investment, which can not quickly be liquidated or sold without great loss to the defendant and its creditors and the creditors of said subsidiary companies, and the plaintiff believes that the assets of the defendant can be properly preserved for equitable distribution among those entitled thereto only by the intervention of a court of equity and the granting of equitable relief, including the appointment of a receiver or receivers, and that said assets upon thus being administered in a court of equity, through said receivership, will be sufficient to pay in full all liabilities against said defendant, and that a surplus will be left for the benefit of defendant's stockholders.

WHEREFORE as plaintiff has no adequate remedy at law and can have relief only in a court of equity, the plaintiff files this bill of complaint on behalf of himself and of all other creditors of the defendant who may choose to join therein and take the benefit hereof, and pray for equitable relief as follows:

(1) That this Honorable Court administer all and singular the property, rights and assets of defendant and [fol. 45] adjudicate, enforce and adjust all rights, liens, equities and claims of all creditors of defendant therein, including plaintiff, as the same may be determined.

(2) That in order to preserve and protect the properties and assets of defendant and in order that the same may be held together, operated, and ultimately sold or otherwise disposed of as a going entirety, this Honorable Court forthwith appoint a receiver or receivers of all and singular the property and assets of every nature, wheresoever located, held, owned or controlled by defendant, with full power and authority to take into his or their possession and to hold such property and assets and to con-

tinue, manage and operate as a whole the business now being conducted by the defendant, and with all incidental powers ordinarily vested in a receiver or receivers in like cases and with such other powers as this Honorable Court may from time to time grant.

(3) That said receiver or receivers be authorized and empowered to bring suit for, collect and receive and take into his or their possession all the property and assets, real, personal or mixed, goods, chattels, credits, rights, claims and equities, books, papers, securities, cash and other property of defendant whatsover and wheresoever situated; and to institute, prosecute, become party to, intervene in, compromise or defend suits and actions at law or in equity or otherwise, either for the recovery or protection or maintenance of any of the property and assets of defendant or otherwise, as he or they may deem necessary or proper, including such ancillary proceedings in any court or courts of the United States or of any state or of any foreign nation as he or they may deem advisable, and including also any other suits, actions or proceedings in which defendant may have any interest as plaintiff, defendant or otherwise, with the power to continue any [fol. 46] such pending suits, and to defend or otherwise dispose of any such proceedings, suits or actions; to settle, compound and make allowances on any or all debts now due and owing or which may hereafter be due or owing to defendant, as he or they may deem advisable or proper.

(4) That said receiver or receivers be authorized and empowered to continue the operation of the business of defendant as an entirety and to that end to employ and discharge and pay the compensation, salaries and wages of such attorneys, managers, superintendents, agents, accountants, bookkeepers, servants, workmen and employes as he or they may deem necessary or advisable in connection with the custody, control, preservation and management of the properties and business of said defendant; and to protect and manage the business of the defendant and its subsidiary companies as an entirety, according to the customary and usual manner of conducting similar businesses, under the orders and directions of this Court, and until the further order of this Court in the premises; and that defendant, its officers, managers, servants, agents

and employees, creditors of defendant and all other persons, firms and corporations be required forthwith to deliver up to said receiver or receivers and to transfer and convey to him or them all and every part of the property of defendant wheresoever situated.

(5) That in managing and operating the business of defendant, or in the process of the liquidation of the assets of said defendant, said receiver or receivers be authorized to act in association with any ancillary receiver or receivers who may be appointed by any other court to take possession of and operate any property or assets of defendant, or in which defendant may have an interest, situated outside the territorial jurisdiction of this court, [fol. 47] and to co-operate with any ancillary receiver or receivers in continuing, managing and operating said business as a whole.

(6) That all creditors and stockholders of defendant and all other persons, firms and corporations be enjoined from instituting or prosecuting or continuing the prosecution of any actions, suits or other proceedings at law or in equity or under any statute against defendant, and from levying any attachments, executions or other processes upon or against any of the properties of defendant, or from taking or attempting to take into their possession any part of the property of defendant and from doing any act whatsoever to interfere with the possession and management by said receiver or receivers of the properties and business of defendant or in any way to interfere with said receiver or receivers in the discharge of his or their duties or to interfere in any way with the administration and disposition in this suit of the affairs and properties of defendant.

(7) That a writ or writs of injunction issue out of and under the seal of this Honorable Court directing, enjoining and restraining defendant and its stockholders, directors, officers, superintendents, managers, attorneys, agents and employees, and all other persons, firms and corporations, from interfering with, transferring, selling or disposing of any of the property or income of defendant or from taking possession of or attaching or levying upon, or attempting to sell or dispose of in any manner, any part of the property of defendant.

(8) That at such time or times as may be found just and proper the properties of defendant may be ordered to be sold in whole or in part in such manner and upon such terms and conditions as this Honorable Court shall deem [fol. 48] just and equitable, and that any such order of sale shall make proper and suitable provision for the preservation of all equities, rights, priorities, claims and liens of the creditors of defendant, and shall provide for the sale of the property of defendant subject to or free and clear of any and all liens and encumbrances, in whole or in part, in such manner and upon such terms as this Honorable Court may direct, and that the proceeds of any such sale be distributed among those entitled thereto, as this Honorable Court may adjudicate, and that in case of any sale herein of the property of defendant, it and its necessary officers, agents and attorneys may be directed to make, execute and deliver to the accepted purchaser or purchasers upon any such sale such releases, bills of sale and conveyances as may be necessary or proper to vest in such purchaser or purchasers the title to all and singular the purchased properties; or that the properties of defendant may be returned to defendant if and to the extent that proper provision shall be made for the claims of complainant and other creditors of the defendant.

(9) That a writ of subpoena under the seal of this Honorable Court may be granted to the plaintiff directed to defendant, commanding it on a certain day therein named, under a certain penalty, to appear before this Honorable Court to answer (but not under oath, an answer under oath being hereby expressly waived) this bill of complaint and each and every statement and allegation herein made, and further to perform and abide by such orders, directions and decrees as may be made against it in the premises and as shall seem proper and right in equity and in good conscience.

(10) That the plaintiff may have such other and further relief in the premises as the nature and circumstances [fol. 49] of this case may require and as to this Honorable Court may seem just and proper.

Milon Stone, Plaintiff.

Herbert J. Friedman, Solicitor for Plaintiff.

STATE OF ILLINOIS,
County of Cook:

Milon Stone, being first duly sworn, on oath says that he is the plaintiff in the above entitled cause, and has read the foregoing bill of complaint by him subscribed and knows the contents thereof, and says that the same is true of his own knowledge, except as to the matters therein stated to be on information and belief, and as to those matters he believes said bill of complaint to be true, and further that deponent has knowledge of the facts upon which the special relief pending suit is asked.

Milon Stone.

Subscribed and sworn to before me this 15th day of June, A. D. 1932. Jeanette Levin, Notary Public. (Seal.)

[fol. 50] UNITED STATES OF AMERICA,
Northern District of Illinois, ss:

I, Roy H. Johnson, Clerk of the United States District Court in and for the Northern District of Illinois, do hereby certify that the annexed and foregoing is a true and full copy of the original Bill of Complaint filed June 16, A. D. 1932, in cause entitled: Milon Stone vs. The Hartman Corportion, a corporation, Equity No. 11961, now remaining among the records of the said Court in my office.

In Testimony Whereof, I have hereunto subscribed my name and affixed the seal of the aforesaid Court at Chicago, Illinois this 10th day of June, A. D. 1943.

Ray H. Johnson, Clerk. Daniel W. Lean, Jr., Deputy Clerk.

[fol. 51] EXHIBIT 2-B, ANNEXED TO FOREGOING STIPULATION OF FACTS

IN THE DISTRICT COURT OF THE UNITED STATES FOR THE NORTHERN DISTRICT OF ILLINOIS, EASTERN DIVISION

In Equity No. 11961

MILON STONE, Plaintiff,

vs.

THE HARTMAN CORPORATION, a Corporation, Defendant

ORDER APPOINTING RECEIVERS

This cause coming on to be heard on the bill of complaint herein and the answer thereto of defendant admitting the allegations of said bill of complaint and said answer and having heard the arguments of counsel, and being fully advised in the premises, it is

Ordered, adjudged and decreed:

1. That Martin L. Straus and Elias Mayer, of the City of Chicago, Cook County, Illinois, be, and they hereby are, appointed Receivers of said defendant The Hartman Corporation, a corporation, and of all and singular the business, assets and property, real, personal and mixed, of said defendant, of whatsoever kind and description and where-[fol. 52] soever situated the same may be, including as part of such property all stocks, bonds, deeds, leases, contracts, rights, choses in action, credits, accounts receivable, leasehold interests and privileges, cash in bank and all other monies, rents, profits and income accrued, accruing and to accrue, and all books, accounts, records and other books and papers, and all other kinds and species of property or property rights of whatsoever kind or nature or wherever situated the same may be.

2. That said Receivers be, and they are hereby authorized and directed to take immediate possession of all and singular said business, assets, property and property rights hereinabove mentioned wheresoever situated or found, subject to any and every lawful lien upon or pledge of any such property, and to preserve and protect said property and the rights and titles of the defendant in and to the same, and to conduct, carry on and manage the business of said

defendant, and to exercise all and singular defendant's rights, authorities, franchises and privileges, in such manner and to such extent as in their judgment may be necessary or desirable; and that said Receivers are hereby authorized to make leases for the necessary space in the maintenance and operation of said business of defendant, and to retain, employ, discharge and fix the compensation of all necessary officers, directors, managers, superintendents, agents, accountants, bookkeepers, attorneys and employees for the due administration and management of the properties and of the business of said defendant; to keep the property of said defendant insured to such extent as said Receivers may deem advisable; to carry out and perform such existing contracts and agreement as may be necessary for the preservation of said property and business, or any part thereof, and of the rights of defendant therein; to enter into and perform other contracts in the [fol. 53] regular course of the business of defendant, which may in the judgment of said Receivers be necessary or desirable in order to conduct said business to the best interests of defendant and its creditors; to collect and receive all outstanding accounts, things in action, or credits due or owing to said defendant, and to hold and retain the net revenue thereof, for distribution or disbursements pursuant to the order of this Court; and to otherwise have and exercise all the powers of receivers in equity usual in such cases. Said Receivers shall cause all monies coming into their hands under and by virtue of the powers hereby conferred to be deposited in responsible banks or trust companies to the credit of said Receivers in their official capacity, and shall report to this Court the banks or trust companies selected by them for such deposit.

3. That the defendant and all persons, firms and corporations in possession or control of any of defendant's property or assets hereinabove mentioned are, and each of them is, hereby ordered forthwith to deliver the same to said Receivers, or their duly constituted representatives; and said Receivers are hereby authorized and empowered to bring suit for, collect, receive and take into their possession all the property and assets of defendant hereinabove mentioned, and to institute, prosecute, become party to, intervene in, compromise or defend suits and actions at law or in equity, or otherwise, for the recovery or protec-

tion or maintenance of any of said property or assets of defendant, as they may deem necessary or proper, including the institution and prosecution of such ancillary proceedings in any court or courts of the United States or of any state or of any foreign nation, as they may deem advisable, and including also any other suits, actions or proceedings at law or in equity, or otherwise, in which defendant may have any interest as plaintiff, defendant or [fol. 54] otherwise, with the power to continue any such pending suits, and to defend or otherwise dispose of any such proceedings, suits or actions; to settle, compound or make allowance on any or all debts now due and owing or which may hereafter be due or owing to defendant, as said Receivers may deem advisable or proper; said Receivers are further authorized to execute in their own names, or in the name of the defendant, all necessary appeal, supersedeas, injunction, or other bonds which may be required by law or in carrying out this order or any other order of this Court, and to that end to enter into contracts with surety companies as sureties on such bonds.

4. That said Receivers are further authorized, from monies received by them from time to time from any source, to make proper payment, in their discretion, of current and unpaid payrolls, also of all bills for merchandise, materials and supplies, incurred in the ordinary operation of the business of said defendant corporation from time to time, also to pay the expenses of maintaining and operating the said business and property from and after this date, and all expenses of protecting the rights and titles of said defendant corporation and prosecuting and defending suits, and also to pay any taxes and assessments levied upon said property and assets, or any part thereof, which, in the judgment of said Receivers, it is necessary to pay; and, if needful, in their judgment, in order to comply with the directions herein, in whole or in part, to borrow money and issue Receiver's certificates therein, upon such terms as the Court may by order hereinafter approve and direct.

5. That the plaintiff and the Receivers appointed herein are authorized to apply to any other court, or courts, of competent jurisdiction for such order, or orders, in the premises as the plaintiff or the Receivers may deem neces- [fol. 55] sary or proper in aid of the orders issued by this Court, or to apply from time to time to this Court for any

further orders or directions to said Receivers; and this Court reserves the right and jurisdiction to make, from time to time, such further orders, amplifying, extending, limiting or otherwise modifying this order as to it may at any time seem proper. In case of the death, resignation or removal of any of Receivers hereby or hereafter appointed, and the appointment of a successor, or successors, all of the provisions of this order shall apply to such successor, or successors, without further order or direction of the Court.

6. That in the management and operation of said business, said Receivers are hereby authorized to act in association with any ancillary receiver, or receivers, who may be appointed by any other court to take possession of and operate any property or assets of defendant, or in which defendant may have an interest, situated outside the territorial jurisdiction of this Court, and to co-operate with any ancillary receiver, or receivers, in continuing, managing and operating said business.

7. That said Receivers shall retain possession of said property and business of defendant, and shall continue to discharge the duties and trusts aforesaid until the further order of this Court in the premises; said Receivers shall open and keep proper books of account of all monies received and disbursed by them, and shall, from time to time, make reports to this Court of their doings in the premises, and apply to this Court for such other and further orders and directions as they may deem necessary or requisite for the due administration of said trust, including the power to borrow money on Receivers' certificates, or otherwise, and to give security therefor.

[fol. 56] 8. That said defendant, its officers, directors, agents, attorneys and employes, creditors and stockholders, and all other persons, firms and corporations, be, and they are hereby restrained and enjoined from instituting or prosecuting or continuing the prosecution of any actions, suits or other proceedings at law or in equity, or otherwise, against defendant, and from levying any attachments, executions or other processes upon or against any of the properties or assets of defendant, or in any manner whatsoever disturbing any operation of the property and business for which said Receivers are hereby appointed, or from taking possession of or in any way interfering with

said property or any part thereof, or from interfering in any manner to prevent the discharge by said Receivers of their duties, or the operation of said business and property under the order of this Court.

9. That said Receivers shall, as soon as practicable, within 3 days from this date, execute and file with the clerk of this Court a bond in the sum of Fifty Thousand Dollars ($50,000.00), with one or more sureties, to be approved by one of the judges of this Court, for the benefit of whom it may concern, conditioned that they will faithfully discharge the duties of their offices of receivers, and duly account for all monies and property that may come into their hands, and abide by and perform all things which they as said Receivers may be directed to do herein and in any ancillary proceeding wherein they may be appointed as receivers.

Enter:

(Signed) James H. Wilkerson, Judge.

June 16, 1932.

[fol. 57] EXHIBIT 3-C, ANNEXED TO FOREGOING STIPULATION OF FACTS

TO THE STOCKHOLDERS:

We submit herewith consolidated balance sheet and Surplus account for the year ended December 31, 1931, as certified by our accountants, Messrs. Haskins & Sells.

During the depression, your Company's sales dropped. With a decrease in commodity prices, the worth of its inventories declined. Unprecedented credit losses were incurred due to widespread unemployment. These causes account for $1,800,000 of the year's losses, of which the greater portion was charged against current operations. Capital assets shrunk materially in value and were charged against surplus.

Adverse business conditions presented a situation which had to be courageously and constructively met to assure the corporation's future welfare. Many changes in policy were inaugurated and are now being pursued in order to improve the corporation's operations in succeeding years as rapidly as conditions will permit. The full results should

be reflected in present and future operations. Among these are the following:

(1) All stores beyond a hundred mile radius of the main store in Chicago have been closed in order to assure more efficient supervision and operation.

The saving of rents on closed stores and the revision of rentals on operated stores generally to a sales percentage basis already accomplished will save the Company in ensuing years approximately $350,000 per annum. This saving is being increased as we adjust other leases.

(2) We have charged to surplus $761,648 as a result of the loss incurred in the closing of these stores. This loss cannot reoccur.

[fol. 58] (3) The following accomplishments as a result of our new policies will reduce the use of working capital per dollar of sales by approximately fifty per cent, and also curtail our credit losses materially:

(A) Tripling our cash business.
(B) More than doubling our down payments.
(C) Greatly increasing the rate of collections.

(4) Our inventories have been reduced from $2,050,000 on December 31, 1930, to $1,270,000 on December 31, 1931. They are marked down to a basis as low or lower than our cash competitors, and we now add a more adequate charge for credit extension, thereby absorbing the extra cost of credit sales.

(5) We have cut expenses not only in the usual ways, operating with lesser personnel at a smaller average wage, reducing salaries, wages, etc., but also by the introduction of new money-saving systems and methods.

(6) Our aggressive sales policy has stemmed the tide of losing sales volume with the result that in the last three months of 1931, we showed an increase in sales volume, and but for the progressively bad general conditions prevailing during the first three months of 1932, would have continued to show this increase. Nevertheless, we show a decrease of only 8.10% during the first quarter of 1932, and 5.28% during the month of March, 1932, as against average loss of volume in comparable lines of business of many times this

amount. (These figures do not include the newly inaugurated Apparel Department.)

(7) Monies borrowed have been reduced from a peak of $7,900,000 in 1930 to $5,872,000 at the end of 1930, to [fol. 59] $3,250,000 at the end of 1931, and to $2,800,000 on this date, thus effecting large savings in interest. Gross installment accounts receivable of $9,925,000, including accounts sold at the end of 1930, have been collected and reduced to $6,040,000 on December 31, 1931.

In line with good business practice, a reduction of bookkeeping charges of more than $250,000 per year has been accomplished by writing down to the nominal figure of $1.00, all furniture, delivery equipment, building improvements, etc., and a substantial reserve for contingencies of $1,250,000 has been set up.

Furthermore, the Directors have also fixed the capital represented by Class "B" shares at $10.00 a share and have thereby made additions to capital surplus, as shown in the accompanying balance sheet.

Profits for 1932 are unlikely in the face of current conditions, but losses should be greatly minimized. With a return to more normal business and economic conditions, profits again should be realized. It is estimated that our loss for the first quarter of 1932 will show at approximately $400,000 less than for the corresponding period of 1931.

The Company is cautiously extending its operations into other lines of merchandise salable for cash only and at low operating expense.

We wish to express appreciation to the shareholders, executives and employees for their loyal cooperation.

Let us look forward with confidence to the future business in the United States, and with the expectation that the profitable business, which this 67 year old Company uninterruptedly enjoyed until the present depression, will be restored.

By Order of the Board of Directors, Martin L. Straus, President.

Chicago, Illinois, April 4, 1932.

[fol. 60] THE HARTMAN CORPORATION (Incorporated in Virginia) and Subsidiary Companies

Consolidated Balance Sheet December 31, 1931

(Adjusted to Give Effect to a Reduction, Authorized by the Directors on April 4, 1932, in the Stated Value of Class "B" Capital Stock and to a Write-Down of Fixtures, Delivery Equipment, and Leasehold Improvements to a Nominal Valuation of $1.00.)

ASSETS

Current Assets:		
Cash		$221,124.40
Cash deposited under collateral trust agreement		140,927.85
Receivables pledged as collateral to collateral trust notes:		
Customers' instalment accounts	$6,040,900.93	
Less reserve for doubtful accounts	664,499.10	
Customers' instalment accounts—Net		5,376,401.83
Instalment notes (including accrued interest)	$638,051.73	
Less reserve for losses	105,898.64	
Instalment notes—Net		532,153.09
Receivables applicable to Home Complete Division:		
First mortgages (including accrued interest)	$996,811.55	

[fol. 61]

Second mortgages, contracts, notes and accounts receivable	398,919.18	
Total	$1,395,730.73	
Less reserve for losses	122,125.00	
Remainder		1,273,605.73

Receivables not pledged:		
Notes receivable—Miscellaneous (including accrued interest)	43,225.50	
Accounts receivable—Sundry	120,469.26	
Total		163,694.76
Merchandise and supplies (physical inventories at the lower of cost or market; not audited as to quantities)		1,270,183.56
Total current assets		$8,978,091.22
Investments (at book value):		
Affiliated Company and Trust not consolidated (The Seventh and Mitchell Realty Corporation, $65,-[illegible].84, and Hartman Realty Trust, $839,364.66)	$905,342.50	
Equity in real estate	133,315.09	
Other	331,831.62	
Total investments		1,370,489.21
Fixtures, Delivery Equipment, and Leasehold Improvements—Nominal Valuation		1.00
Deferred Charges		59,524.15
Good-Will		4,992,992.39
Total		$15,401,097.97

[fol. 62] LIABILITIES

Current Liabilities:	
Collateral trust notes (receivables pledged as collateral—See contra)	$3,250,000.00
Accounts payable	435,972.49
Purchase money obligations, maturing within one year	56,000.00
Accrued accounts:	
Real estate and personal property taxes (estimated)	322,921.02
Miscellaneous	133,919.75
Total current liabilities	$4,198,813.26

Purchase Money Obligation and Notes Payable—Deferred Maturities		35,466.00
Hartman Realty Trust—Accounts Payable Deferred		234,159.21
Federal Income Tax (Including Accrued Interest)—in Dispute		272,000.00
Reserve for Contingencies		1,250,000.00
Net Worth:		
Capital stock:		
Class "A" — Authorized, 200,000 shares of no par value; issued, 59,072 shares	59,072.00	
Class "B"—Authorized and issued, 335,121 shares at a stated value of $10.00 a share	3,351,210.00	
Total capital stock	$3,410,282.00	
Capital surplus, per accompanying summary	6,000,377.50	
Total net worth		9,410,659.50
Total		$15,401,097.97

[fol. 63] EXHIBIT 4-D, ANNEXED TO FOREGOING STIPULATION OF FACTS

May 4, 1932.

To the Stockholders:

Newspapers have recently carried announcement of the results of the annual meeting of The Hartman Corporation at which there were voted 248,000 shares of stock in favor of the management and no stock voted in opposition. The directors and officers of the corporation appreciate this vote of confidence by its stockholders. Unity and harmony are essential if we are to overcome the adverse forces affecting business.

While the election of our general counsel, Elias Mayer, represented the only addition to the directorate, stock-

holders will be interested in noting the identity of the individuals on the board of their corporation:

H. W. Blumenthal, New York, Partner, Hallgarten & Co.
Adolf Drey, Chicago, Second Vice-President, The Hartman Corporation.
Melvin L. Emerich, Chicago, Partner, Hallgarten & Co.
Sidney H. Kahn, Chicago, Vice-President, Straus National Bank and S. W. Straus & Co.
Morton J. May, St. Louis, President, The May Department Stores Company.
Elias Mayer, Chicago, Attorney-at-Law.
Barton H. Sackett, Chicago, Secretary, The Hartman Corporation.
Martin L. Straus, President and Chairman, The Hartman Corporation.
Harold B. Wess, Chicago, Executive Vice-President, The Hartman Corporation.

At the board meeting yesterday the following officers were elected:

[fol. 64] Chairman and President, Martin L. Straus; Executive Vice-President (General Manager), Harold B. Wess; Second Vice-President (Sales Promotion Manager), Joseph S. Batt; Second Vice-President (Division Merchandise Manager), Jack Blostein; Second Vice-President (Division Merchandise Manager), Adolf Drey; Second Vice-President (Manager Wisconsin Div.), Charles A. Frank; Second Vice-President (Manager of Operations), Barton H. Sackett; Secretary, Barton H. Sackett; Treasurer and Assistant Secretary (Comptroller), William H. Yates; Assistant Secretary and Assistant Treasurer, Meyer Kuit.

The Executive Committee of the Board of Directors comprises Messrs. Straus (Chairman), Wess, Mayer and Emerich.

Stockholders will be interested in knowing that borrowed monies have been further reduced—an effort on which the management has concentrated for the last year. The total is down from a peak of $7,900,000 in 1930 to $2,675,000 on April 30—a reduction of $575,000 since the first of this year and a new low since 1924.

Business has not shown any improvement but your corporation has shown a much smaller sales decline than most

merchandising companies. In the four months ending April 30, 1932, net sales were 8.68 per cent less than in the corresponding period of last year.

[fol. 65] We believe that this comparatively favorable showing is directly traceable to the fact that The Hartman Corporation has been passing on to its customers the full benefit of low prices for merchandise now prevailing, and has, as a result, been able to offer the best values per dollar in its history. We are making every possible effort to bring these to the attention of more people, and do the largest volume of business that can be attracted to our stores.

We earnestly solicit the assistance of our shareholders, particularly those within the trading area of our retail stores. You are invited to visit our nearest store and see for yourself how it is conducted, and what is offered. The style and quality of merchandise and service, the low prices, make Hartman stores the logical place for your own purchases, and for recommendation to your friends. A considerable number of such recommendations result in added sales, so that you will directly benefit yourself as a stockholder.

Several months ago we installed experimentally a cash and carry, self-service women's ready-to-wear department in the Loop Store at Wabash Ave. and Adams St., Chicago. This experiment, which was undertaken at a minimum of expense, has been growing satisfactorily to date. Sales have run as high as 1,000 garments a day. If this record is maintained over a sufficient time to indicate the department's reliability as a sales and earnings producer, similar departments will be installed in other stores.

The management of Hartman Corporation is constantly alert to realize on new merchandising developments touching the fields its covers. This aggressive attitude will, I am confident, give the corporation the best showing during the remainder of the year that business conditions will permit.

Sincerely, Martin L. Straus, President.

[fol. 66] EXHIBIT 5-E, ANNEXED TO FOREGOING STIPULATION OF FACTS

June 7, 1933.

To the Creditors of Hartman Furniture & Carpet Company and the Stockholders of The Hartman Corporation:

The undersigned, Hartman's Incorporated, has been organized under the laws of the State of Delaware for the purpose of acquiring at the bankruptcy sale the business and property of Hartman Furniture & Carpet Company (herein called the "Company") and of consummating the program outlined in the letter of the Stockholders' Protective Committee dated April 27, 1933.

In order to procure the underwriting of debentures sufficient to provide the cash requirements under the program outlined in the Committee's letter, the present management voluntarily agreed to purchase $150,000 of debentures with the accompanying stock, and to subordinate the principal of (but not the interest on) said $150,000 of debentures to a like principal amount of debentures; the purchasers of the $150,000 of debentures enjoying priority having agreed to deliver the accompanying stock to the present management as and when said debentures have been retired. The remaining $100,000 of debentures authorized were free and unsubordinated.

The sale of the business and property of the Company was held by the bankruptcy court on May 26, 1933, and the undersigned was the successful bidder at said sale, the purchase price being:

(*a*) $501,000.00 in cash; and

(*b*) Agreement to procure a waiver of claims of certain affiliated companies.

[fol. 67] Inasmuch as the amount of cash required in connection with this purchase is substantially in excess of the amount contemplated in the program outlined in the Committee's letter, it has become necessary to modify the plan set out in the Committee's letter by increasing the authorized debentures from $400,000 to $600,000; by subordinating the principal of (but not the interest on) the additional $200,000 of debentures to the same $150,000 of debentures so given priority under the original plan and by increasing the authorized number of shares from 150,000 to 225,000.

The undersigned offers to issue to each creditor of the Company, without payment by the creditors, one share of fully paid and non-assessable capital stock of the par value of $1.00 per share, for each $100.00 of provable claims as may be filed and allowed in the bankruptcy proceedings on or before June 26, 1933, or as shown upon the books of the Company.

In addition, the undersigned also offers the privilege of subscribing for units of its debentures and capital stock upon the following basis:

(*a*) Creditors of the Company may, for each $100.00 of claims filed and allowed in the bankruptcy proceedings on or before June 26, 1933, or as shown on the books of the Company, subscribe for one unit consisting of a Six Per Cent Sinking Fund Debenture in the face amount of $10.00 and two shares of capital stock of the par value of $1.00 per share, at a subscription price in cash of $10.00 per unit, plus accrued interest on the debenture at 6% from June 1, 1933 to date of payment.

(*b*) Holders of Class "A" and Class "B" stock of The Hartman Corporation may, for each ten shares of either class of stock, subscribe for one unit consisting of a Six Per Cent Sinking Fund Debenture of the [fol. 68] *of the* par value of $1.00 per share, at a subscription price in cash of $10.00 per unit, plus accrued interest on the debenture from June 1, 1933 to date of payment.

The foregoing debentures, for which the privilege of subscription is herewith offered, are subject to a certain subordination agreement of Hartman's Incorporated dated June 1, 1933, providing in substance that the principal of (but not interest on) the debentures herewith offered to creditors and stockholders shall be subordinated to the principal payment upon debentures in the aggregate amount of $150,000.00, referred to and described in said agreement, copies of which are on file and may be inspected at the office of Barton H. Sackett, Trustee, and Hallgarten & Co., Chicago, Fiscal Agent, and each debenture will bear an appropriate legend to that effect.

The entire proceeds of debentures and accompanying stock subscribed for by creditors and stockholders will be

first used either to cancel the subscriptions to, or redeem and retire, unsubordinated debentures and debenture enjoying priority, at par and accrued interest.

The foregoing stock given to creditors and the privileges of subscription herewith offered are in addition to the cash dividends which creditors are entitled to receive in the bankruptcy proceedings.

All subscriptions by creditors of Hartman Furniture & Carpet Company must be accompanied by the full cash subscription. All subscriptions by stockholders of The Hartman Corporation must be accompanied by either certificates of deposit of the depository of the Stockholders' Protective Committee or certificates of stock of The Hartman Corporation, endorsed in blank, in respect of which the subscription is made, and also by the full cash subscription.

The undersigned reserves the right, in the event that more than thirty-five thousand units are subscribed for [fol. 69] by the creditors and stockholders, to allocate the units ratably in proportion to the subscriptions, and to reject the excess subscriptions.

No subscriptions will be accepted from stockholders for fractional units and no stock will be issued to, or subscriptions accepted from, creditors with respect to claims less than $100.00 or for odd amounts in excess of $100.00 or multiples thereof.

The authorized capital stock of Hartman's Incorporated is 225,000 shares, of the par value of $1.00 a share. An issue of Six Per Cent Sinking Fund Debentures in an aggregate principal amount not exceeding $600,000.00 has been authorized. The Debentures will be dated June 1, 1933, mature June 1, 1935, bear interest at the rate of 6% per annum, payable semi-annually, will be registered and will be subject to redemption, in whole or in part, at any time upon ten days' notice to the registered holder, on payment of the par value thereof plus accrued interest to the date of redemption. The Debentures will be issued pursuant to an Indenture of Trust dated June 1, 1933, making provision, among other things, for a pledge as security for the payment of the Debentures, of the equity in the accounts receivable, notes and other collateral now pledged to secure the Collateral Promissory Notes of the Company, remaining after the payment in full of all such notes.

Hallgarten & Co. of New York and Chicago have purchased 15,000 units, each consisting of $10.00 par value of

Debentures and two shares of capital stock and have underwritten 35,000 additional units, or so many of such units as the creditors and stockholders do not subscribe for pursuant to this offer. 87,000 shares of the capital stock and $30,000 cash have been reserved by the undersigned to be used in payment of the underwriting, reorganization and purchase expenses and for other corporate purposes. A summary of the appraisal of the property and assets pur- [fol. 70] chased, prepared by the bankruptcy court appraisers, without adjustment or valuation by the undersigned, is given herewith.

If you desire to avail yourself of the foregoing offer, you should fill in the enclosed subscription form and forward same, together with a check or money order for the full subscription price at the rate of $10.00 per unit and accrued interest (and in the case of stockholders, certificates of deposit or certificates of stock) to Hartman's Incorporated, 100 West Tenth Street, Wilmington, Delaware, on or before June 30, 1933.

Very truly yours, Hartman's Incorporated.

Note: We are advised by the Stockholders' Protective Committee that deposited stock certificates will be returned by the Committee's Depositary, First Union Trust and Savings Bank, Chicago, Illinois, upon surrender of certificates of deposit duly endorsed for transfer.

Summary of Report of Bankruptcy Appraisers as of April 19, 1933

1.	Merchandise at all stores		$152,641.83
2.	Store Furniture, Fixtures, and Trucks		59,597.20
	Accounts Receivable:		
3.	Equity in Pledged Accounts	$427,295.95	
4.	Free Accounts	94,538.20	
5.	Miscellaneous	7,958.42	529,792.57
6.	Promissory notes secured by Sales Contracts or Mtges		51,781.45
7.	Other Promissory Notes		9,000.00
8.	Stocks, Bonds, Warrants & other Securities		57,168.32
9.	Real Estate, Improved and Vacant		111,450.00
10.	Real Estate Mortgages and Contract		554,150.00
	Total		$1,525,581.37

[fol. 71] EXHIBIT 6-F, ANNEXED TO FOREGOING STIPULATION OF FACTS

EXHIBIT II

SUPREME COURT OF THE STATE OF NEW YORK, NEW YORK COUNTY

BENJAMIN GRAHAM, THERESE S. ROSENBLATT, MAXWELL HYMAN, Herbert W. Levy, and Guy W. Levy, co-partners, trading as Levy Brothers, and Edwin A. Seasongood and George C. Haas, co-partners, trading as Seasongood & Haas, Lillian Boehm, and Louis Boehm, Plaintiffs,

against

MARTIN L. STRAUS, SAMUEL E. KOHN, BARTON H. SACKETT, Edward G. Felsenthal, Adolph Drey, Morton J. May, H. Walter Blumenthal, Melvin L. Emerich, Sidney H. Kahn, The Hartman Corporation, Defendants

To the above named Defendants:

You are hereby summoned to answer the complaint in this action, and to serve a copy of your answer, or, if the complaint is not served with this summons, to serve a notice of appearance, on the plaintiffs' attorneys within twenty days after the service of this summons, exclusive of the day of service. In case of your failure to appear or answer, judgment will be taken against you by default for the relief demanded in the complaint.

Dated, New York, December 16th, 1932.

Boehm & Zeiger, Attorneys for Plaintiffs, Office & P. O. Address, No. 30 Broad Street, Borough of Manhattan, New York City.

[fol. 72] SUPREME COURT OF THE STATE OF NEW YORK, NEW YORK COUNTY

BENJAMIN GRAHAM, THERESE S. ROSENBLATT, MAXWELL HYMAN, Herbert W. Levy, and Guy W. Levy, co-partners, trading as Levy Brothers, and Edwin A. Seasongood and George C. Haas, co-partners, trading as Seasongood & Haas, Lillian Boehm, and Louis Boehm, Plaintiffs,

against

MARTIN L. STRAUS, SAMUEL E. KOHN, BARTON H. SACKETT, Edward G. Felsenthal, Adolph Drey, Morton J. May, H. Walter Blumenthal, Melvin L. Emerich, Sidney H. Kahn, The Hartman Corporation, Defendants

The plaintiffs, by Boehm & Zeiger, their attorneys, suing on behalf of themselves as stockholders of The Hartman Corporation, and on behalf of the said Company and all other stockholders of said Company similarly situated, who may join with the plaintiffs in, and contribute to the expenses of, this suit respectfully allege:

1. That the plaintiff, Benjamin Graham, at all the times mentioned in the complaint, was and now is, the owner and holder of 1,600 shares of the Class "A" stock of the defendant, The Hartman Corporation, hereinafter called the "Corporation".

2. That the plaintiff, Therese S. Rosenblatt, at all the times mentioned in the complaint, was, and now is the owner and holder of 400 shares of the Class "A" stock of the defendant Corporation.

[fol. 73] 3. That the plaintiff, Maxwell Hyman, at all the times mentioned in the complaint, was, and now is the owner and holder of 100 shares of the Class "A" stock of the defendant Corporation.

4. That at all the times mentioned in the complaint, the plaintiffs, Herbert W. Levy and Guy W. Levy, were, and still are, co-partners, trading under the firm name of Levy Brothers, and were, and still are, the owners and holders of 300 shares of the Class "A" stock of the defendant Corporation.

5. That at all the times mentioned in the complaint, the plaintiffs Edwin A. Seasongood and George C. Haas, were, and still are, co-partners, trading under the firm name of Seasongood & Haas, and were, and still are, the owners and holders of 900 shares of the Class "A" stock of the defendant Corporation.

6. That the plaintiff, Lillian Boehm, at all the times mentioned in the complaint, was, and now is the owner and holder of 1100 shares of the Class "A" stock of the defendant Corporation.

7. That the plaintiff, Louis Boehm, at all the times mentioned in the complaint, was the owner of 7 shares of Class "A" stock and 115½ shares of the Class "B" stock of the defendant Corporation.

8. That at all the times hereinafter mentioned, each and all of the plaintiffs were and still are residents of the State of New York.

9. Upon information and belief, that all the times hereinafter mentioned, the defendant Corporation was, and still is, a corporation organized under, and existing by vir- [fol. 74] tue of, the laws of the State of Virginia, engaged in the ownership and operation, through divers wholly-owned subsidiaries, of a chain of retail stores for the sale of house furniture, furnishings, and household goods, in Chicago, Illinois, and other cities, principally in the Middle West of the United States.

10. Upon information and belief, that the capital stock of the Corporation consists of two classes of stock of no par value, namely, Class "A" stock, of which the Corporation is authorized to issue 200,000 shares, of which there was outstanding on and prior to January 1st, 1930, 58,973 shares, and Class "B" stock, of which there was authorized and outstanding on and prior to January 1st, 1930, 400,000 shares; that the Class "A" stock is preferred over said Class "B" stock to the extent of the payment of an annual cumulative dividend of $2.

11. Upon information and belief, that the defendants, Martin L. Straus, Samuel E. Kohn, Barton H. Sackett, Edward G. Felsenthal, Adolph Drey, Morton J. May, H. Walter Blumenthal, Melvin L. Emerich, and Sidney H. Kahn were each and all duly elected directors of the said

Corporation in the year 1929, and have, from year to year since that time, been duly and regularly elected directors of the said Corporation, and that immediately after their election each of them accepted their said office and trust, and took upon himself the duties and responsibilities pertaining to the office of director of said Corporation, and that each and all of them have, during all the times mentioned in the complaint, continued to act and serve as such directors of said Corporation, except the defendants, Samuel E. Kohn and Edward G. Felsenthal, who continued to act as such directors until on or about April 26th, 1932.

[fol. 75] 12. Upon information and belief, that the defendants, Martin L. Straus, Samuel E. Kohn, Barton H. Sackett, Edward G. Felsenthal, and Adolph Drey, were duly elected President, Vice-President, Secretary, Treasurer, and Second Vice-President, respectively, of the said Corporation in the year 1929, and have, from year to year since that time, been duly and regularly elected as such officers of the said Corporation, and that each of them accepted his said office and trust, and took upon himself the duties and responsibilities pertaining thereto, that the said defendants in this paragraph mentioned, have, at all the times mentioned in the complaint, continued to act and serve as such officers of the said Corporation, except the defendants Samuel E. Kohn and Edward G. Felsenthal, who continued to act as such officers until on or about April 26th, 1932.

13. That it was the duty of the said defendants, as such officers and directors, honestly, diligently, prudently and providently to administer the business, affairs, and property of the said Corporation, to conserve the assets of the Corporation and to prevent their waste and dissipation, and otherwise to faithfully and diligently perform all other duties devolving upon them as such officers and directors of the Corporation.

14. Upon information and belief, that the said defendants, as officers and directors, as aforesaid, utterly failed and neglected to perform their official duties as such officers and directors, but, on the contrary, in violation of their duties as such officers and directors and their fiduciary obligations to the Corporation and its stockholders, and in abuse of their power and authority, negligently, imprudently, improvidently, fraudulently, and illegally adminis-

tered the business, and property of the said Corporation, conducted its affairs in an incompetent, wasteful and ex-
[fol. 76] travagant manner, and grossly mismanaged the same, made improvident contracts and purchases in behalf of the Corporation, caused and permitted the Corporation to pay excessive, wasteful and extravagant salaries, and caused, suffered and permitted the working capital of the Corporation to be seriously depl ed, and its assets to be wasted and diminished in value, and curtailed the profitable and successful operation of its business, and substantially impaired its credit and good-will, and otherwise acted in a manner destructive of the Corporation and the rights of its stockholders, to the great damage, loss and prejudice of the Corporation and its stockholders.

15. Upon information and belief that in and about the years 1929 and 1930, the defendant directors and officers caused the Corporation to acquire, in most part by the purchase in the open market for cash, 64,879 shares of its Class "B" stock then outstanding, at an aggregate cost of approximately $1,422,000, which the Corporation paid therefor, representing an average cost of $22 per share.

16. Upon information and belief that at the time the defendant directors and officers undertook to acquire the said stock for the Corporation, the latter had very limited cash resources, having current liabilities in excess of $5,000,000 and cash of approximately only $1,385,000, and was operating its business at a loss, and that the Corporation in such circumstances could ill afford to apply its cash and other current assets to the purchase of its own junior capital stock not essential to the conduct of its business, and to thereby substantially deplete its limited cash resources required for the proper and profitable transaction of its business; and that by reason of the said purchases, the working capital of the Corporation was seriously depleted, and its business impeded and impaired, and the
[fol. 77] Corporation, during the said year 1930, sustained a loss in the operation of its business of $3,350,000, representing approximately twenty (20%) per cent of its total assets, and during the following year of 1931, sustained a further loss of approximately $7,424,000.

17. Upon information and belief, that during the same period, the Corporation was indebted upon notes and ac-

counts payable in the sum of $3,488,000, upon which interest charges amounting to over $400,000, accrued during the year 1930, which the Corpoation was obliged to, and did, pay, but which, however, would have been materially reduced and a considerable savings of interest effected, had the defendant directors and officers applied the said cash funds to the reduction of its existing obligations, instead of to the purchase of its junior Class "B" stock.

18. Upon information and belief, that part of the Class "B" stock of the Corporation so purchased by it; as aforesaid, was sold to it by the defendant directors and officers, and/or by persons acting for them and in their interest, through the open market and otherwise, and that the said defendants personally benefited and profited thereby.

19. Upon information and belief, that the defendants caused said stock, so acquired by the Corporation, at an average cost of $22 per share, to be placed in its Treasury, and thereafter caused the said stock to be retired, when its market value had declined to $3 per share.

20. Upon information and belief, that in and about the year 1929, the defendant directors and officers caused the Corporation to purchase Class "B" stock in the open market, and to re-sell the same to its employees at the price of $16 per share, under agreements with said employees to repurchase the said stock at the same price from the said employees, at the latter's option, all without the knowledge [fol. 78] and consent of the stockholders of the Corporation. That the said purchases of the stock and the said re-purchase agreements, were imprudent, improvident, unfair, disadvantageous and prejudicial to the Corporation and to its stockholders, and imposed a burden upon the Corporation in the event of decline in the market price of the said stock without any compensating profit in the event of a rise in the market price thereof, and that the Corporation was obliged to, and did, purchase, under the said re-purchase agreement, large amounts of the said stock from the said employees at the price of $16 per share, when the market price had declined considerably below the said price, and thereby sustained considerable monetary loss, and suffered waste and dissipation of its assets.

21. Upon information and belief, that similar sales of the Corporation's stock were made to the defendant di-

rectors and officers under similar re-purchase agreements, and that the Corporation was caused to re-purchase a large amount of the said stock from the defendant directors and officers, pursuant to the said agreements, at the price of $16 per share, considerably in excess of the then market price thereof, to the Company's loss and damage.

22. Upon information and belief, that the defendant directors caused to be paid to themselves as officers, salaries and compensation largely in excess of the reasonable value of their services to the Corporation, and wasteful and extravagant.

23. Upon information and belief, that the defendant directors and officers aforesaid, with intent to deceive the stockholders of the Corporation, including the plaintiffs, and in order to lead them to believe that the Corporation was in sound financial condition, and to lull them into a false sense of security as to the nature, amount, and ratio [fol. 79], of its assets and liabilities, and thereby to prevent investigation and inquiry as to the true financial state and condition of the Company, its business and affairs, and the soundness of its management, caused false and misleading letters, statements, and reports to be issued by the Corporation and its Board of Directors, to its stockholders, including the plaintiffs, concerning the assets, liabilities, and financial condition of the Corporation, and concealed from the stockholders the true state, condition, and amounts of its assets and liabilities.

24. That by reason of the acts and mis-feasance, malfeasance, and non-feasance in office of the defendant directors and officers aforesaid, the working capital of the Corporation was materially depleted, its assets were greatly diminished, wasted, and dissipated, and its business seriously impaired and curtailed, and its credit and good-will destroyed, so that it became unable to profitably conduct and continue its business and to meet and discharge its obligations in regular course.

25. That the defendants are the executive officers of the Corporation and constitute the majority of its Board of Directors, and are in control thereof, and that without their consent and direction, this action cannot be brought by the defendant Corporation; that they are the same persons who

are charged with having participated in the acts of mis, mal, and non-feasance in office, alleged in the complaint. That by reason thereof demand upon the corporation to commence and prosecute an action against its aforesaid officers and directors to recover against them the damages which the Corporation has sustained by reason of their official mis-conduct, would be futile, and unavailing, and that the said Corporation has therefore been joined herein as party defendant.

26. That the plaintiffs have no adequate remedy at law.

[fol. 80] Wherefore, plaintiffs demand judgment as follows:

1. That the defendants and each of them, except The Hartman Corporation, be directed to account to the defendant Corporation for their official conduct as officers and/or directors thereof, as the case may be, in the management and disposition of the property and affairs of the said Corporation, and in respect to all of the matters set forth in this complaint;

2. That the liability of the defendants and each of them, be ascertained and determined, and that they be adjudged and decreed to pay into the Treasury of the defendant Corporation the amount of the loss and damage which shall be found to have been sustained by the Corporation by reason of their aforesaid wrongful acts and conduct;

3. That this Court make and award suitable allowance to the plaintiffs for counsel fees and other necessary disbursements incurred in the prosecution of this action on behalf of the defendant Corporation and stockholders, and that it be decreed that the defendant Corporation pay the same to the plaintiffs, and that the plaintiffs have judgment therefor, together with the costs and taxable disbursements of this action.

4. That the plaintiffs have such other and further relief as may be just, equitable, and proper.

Boehm & Zeiger, Attorneys for Plaintiffs, Office & P. O. Address, No. 30 Broad Street, Borough of Manhattan, New York City.

Verification.

[fol. 81] THE TAX COURT OF THE UNITED STATES

Docket No. 111621

LILLIAN BOEHM, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Petitioner's stock in The Hartman Corporation became worthless prior to 1937 and, therefore, deduction therefor is not allowed in that year.

Louis Boehm, Esq., for the petitioner.

P. J. Cavanaugh, Esq., for the respondent.

Memorandum, Findings of Fact and Opinion

The Commissioner determined deficiencies in the amount of $125.63 and $7,537.46 in the petitioner's income tax for the years 1936 and 1937, respectively.

All the issues with reference to the 1936 deficiency and certain of those concerned with that of 1937 have been conceded or abandoned by the parties, and effect will be given thereto in the computation under Rule 50.

The following issues are presented for the year 1937:

(1) Whether the petitioner's stock in The Hartman Corporation became worthless in 1937.

(2) Whether the respondent properly included in her gross income for 1937 the sum of $12,500 received by the petitioner in dismissing a stockholders' suit.

FINDINGS OF FACT

The facts were stipulated and as so stipulated are adopted as findings of fact. In so far as material to the issues presented, the facts are as follows:

[fol. 82] The petitioner, a married woman, resides in New York, N. Y. She filed her separate income tax return for the year 1937 with the collector of internal revenue for the third district of New York.

In 1929 the petitioner purchased 1,100 shares of the Class A stock of The Hartman Corporation, hereinafter called Hartman (Virginia), for $32,440. Hartman (Virginia) was incorporated in 1916 in the State of Virginia to acquire the

capital stock of the Hartman Furniture and Carpet Company, hereinafter referred to as Hartman (Illinois), and its affiliates. Hartman (Illinois) and its affiliates were engaged in the business of selling furniture, carpets, and household goods.

In June 1932, Martin L. Straus and Elias Mayer were appointed equity receivers for Hartman (Virginia) by the District Court of the United States for the Northern District of Illinois, Eastern Division. The receivers entered into possession of the property of Hartman (Virginia) and continued its business of buying and selling furniture and other household articles from the time of their appointment until on or about May 26, 1933.

The petitioner received a letter from Hartman (Virginia) enclosing its balance sheet of December 31, 1931, which showed assets and liabilities of $15,401,097.97 with a total net worth of $9,410,659.50. Accompanying the balance sheet was a statement of the board of directors dated April 4, 1932 addressed to the stockholders, setting forth the policy and procedure of the corporation due to the business depression and stressing the reduction of loans payable and of operating costs. On May 4, 1932, Martin L. Straus, president of Hartman (Virginia) sent another letter to the stockholders stating that business had not shown any improvement and outlining the measures being taken to counteract the existing business conditions.

[fol. 83] In 1933 a new corporation called Hartman's, Inc., was organized under the laws of the State of Delaware. As of May 26, 1933 Hartman's, Inc. purchased at a bankruptcy sale the assets of Hartman (Illinois), the wholly owned subsidiary of Hartman (Virginia), for the sum of $501,000 in cash and an agreement to procure a waiver of certain inter-company claims against the bankrupt estate. The stock of the new company was issued to the creditors of Hartman (Illinois) in settlement of claims, and to the stockholders of Hartman (Virginia) by subscription thereto. The stockholders of Hartman (Virginia) were given the right to subscribe for debentures and capital stock of Hartman's, Inc. The petitioner did not exercise the right of subscribing to the debentures and stock of Hartman's, Inc. and did not acquire any interest in that company in 1933 or thereafter.

On August 10, 1934, the receivers of Hartman (Virginia) filed a report with the court listing as assets $39,593.13 in

cash and a suit pending against the directors (the Graham suit) and as liabilities total outstanding claims amounting to $707,430.67. The receivers recommended that claims totaling $630,574.57 be allowed. By an order dated August 10, 1934, the court approved the report and also awarded $3,500 as compensation to each of the receivers and $5,000 as attorneys' fees.

The receivers filed a second report on July 11, 1935, listing as assets $27,192.51 in cash and the Graham suit pending against the directors and as liabilities the same amount of $707,430.67, representing the total outstanding claims. The receivers recommended that a dividend of 4 per cent be paid on the claims of $630,574.57 allowed and that one claim amounting to $176,856.10 be disallowed. By an order dated the same day the court adopted the report and recommendations of the receivers. On August 26, 1935, one of the two receivers was released from further duties.

[fol. 84] The remaining receiver filed a final report with the court on September 30, 1937. The sole remaining asset was cash in the amount of $1,909.94. Claims totaled $630,574.57. It was recommended that compensation totaling $900 be allowed the receiver and counsel and the remainder be distributed to the creditors. The court adopted the recommendations and discharged the receiver by an order dated September 30, 1937.

A suit against the directors, hereinafter called the Graham suit, was instituted on December 16, 1932 in the Supreme Court of the State of New York. The petitioner and eight other stockholders of Hartman (Virginia) were plaintiffs. The defendants were the corporation, Hartman (Virginia), and nine members of the company's board of directors, all of whom were financially responsible and several of whom were prominent business men. The plaintiffs brought the suit "on behalf of themselves as stockholders of The Hartman Corporation and on behalf of the said Company and all other stockholders of said Company similarly situated, who may join with the plaintiffs in, and contribute to the expenses of this suit."

The complaint set forth the plaintiffs' respective holdings of the capital stock of Hartman (Virginia),[1] its corporate

[1] Each of the plaintiffs owned a block of Class A stock. A plaintiff other than the petitioner also owned a block of Class B stock.

existence and purposes, the number of shares outstanding of Class A and Class B stocks, and alleged the facts that Class A was preferred over Class B as to dividends; that the individual defendants were elected to the board of directors in 1929 and thereafter (excepting two who acted until April 26, 1932); and that certain individual defendants were the officers of the company from 1929 and thereafter (excepting the two who served until April 26, 1932).

[fol. 85] The plaintiffs then charged the defendants with waste, extravagance, mismanagement, neglect, and the fraudulent violation of their duties as officers and directors of the corporation and demanded that the defendants render an accounting and pay into the treasury of the corporation the amount of the loss and damage sustained by it by reason of their wrongful acts.

The complaint charged the defendants with issuing false letters, statements and reports to the stockholders relating to the assets, liabilities and financial condition of the corporation and with concealing the true state and condition of the corporation from the stockholders, including the plaintiffs.

The complaint concluded with the following demand for judgment:

1. That the defendants and each of them, except The Hartman Corporation, be directed to account to the defendant Corporation for their official conduct as officers and/or directors thereof, as the case may be, in the management and disposition of the property and affairs of the said Corporation, and in respect to all of the matters set forth in this complaint:

2. That the liability of the defendants and each of them, be ascertained and determined, and that they be adjudged and decreed to pay into the Treasury of the defendant Corporation the amount of the loss and damage which shall be found to have been sustained by the Corporation by reason of their aforesaid wrongful acts and conduct;

3. That this Court make and award suitable allowance to the plaintiffs for counsel fees and other necessary disbursements incurred in the prosecution of this action on behalf of the defendant Corporation and stockholders, and that it be decreed that the defendant

[fol. 86] Corporation pay the same to the plaintiffs, and that the plaintiffs have judgment therefor, together with the costs and taxable disbursements of this action.

4. That the plaintiffs have such other and further relief as may be just, equitable, and proper.

During the years 1933 to 1936, inclusive, extensive examinations were made of certain of the defendants. Many hundreds of pages of testimony were taken and numerous exhibits were offered in evidence. Pursuant to an order of the New York Supreme Court the petitioner and her coplaintiffs paid expenses and counsel fees of certain of the defendants' attorneys amounting to approximately $800. The plaintiffs in the Graham suit expended approximately $2,000, exclusive of fees, in defraying expenses of their counsel while attending the examinations, in stenographic costs and printing charges.

At the conclusion of the examinations and shortly before the trial, negotiations were commenced for a settlement of the action and on February 20, 1937 such settlement was consummated. Under its terms the defendant directors paid the petitioner and the other plaintiff stockholders the sum of $50,000 in full settlement and discharge of the claims and cause of action of the petitioner and her coplaintiffs. In connection with the settlement the petitioner and the other stockholders released all their rights and claims arising out of the acts committed by the defendants as alleged in the complaint. The suit was dismissed on May 14, 1937.

At the time of the settlement the assets of Hartman (Virginia) consisted of $1,909.94 in cash and the Graham suit and its liabilities amounted to $630,574.57, representing the claims allowed by the court.

The petitioner's proportionate share of the $50,000, after payment of counsel fees and expenses, amounted to $12,500. [fol. 87] In her income tax return for 1937 she claimed a deduction from gross income in the amount of $19,940 as a loss due to the worthlessness of her Hartman (Virginia) stock. The respondent denied the deduction and included in her gross income for that year the sum of $12,500 which she received pursuant to the settlement.

The petitioner claimed a deduction from gross income in her 1934 income tax return in the amount of $32,302 as a loss due to the worthlessness of the 1,100 shares of Class

A Hartman (Virginia) stock. The deduction was denied by the Commissioner on the ground that the stock did not become worthless in the year 1934.

The petitioner at no time received any deduction from her gross income in the determination of her income tax liability by reason of her investment in Hartman (Virginia) stock.

We further find that the petitioner's stock in Hartman (Virginia) did not become worthless in 1937.

Opinion

Van Fossan, *Judge:*

The first issue presents the question of when the petitioner's stock in Hartman (Virginia) became worthless. The petitioner contends that the identifiable event which determined the fact and the extent of her loss due to the worthlessness of the stock was the negotiated settlement of the Graham suit in 1937, and argues that before that occurrence she had no means of ascertaining what, if any, her loss would be.

We are of the opinion that petitioner can not be sustained on this issue. Not only is the evidence insufficient to establish that the stock had any value at the beginning of 1937 and became worthless during that year, it clearly shows that the stock was worthless prior to that year. The financial history of the company, including the receiver-[fol. 88] ship in 1932, the report of August 10, 1934, showing the only assets to be some $39,000 in cash and the Graham suit, against outstanding claims of some $707,000 and the second report in 1935 showing less cash with the same outstanding claims demonstrate the hopeless condition of the corporation. We have no evidence on which to base a conclusion that the Graham suit was an asset of any substantial value. We know nothing of the merits of the suit, the probability of recovery, the assurance of the collection of a judgment, or other essential factors. The stipulated fact that the defendants were men of financial responsibility is not sufficient to establish the collectibility of a recovery equal to the outstanding claims. These claims aggregated more than half a million dollars and had to be satisfied before there would be anything for the stockholders. In our opinion, all value had gone from the

stock prior to 1937. We sustain respondent in his disallowance of the claimed loss.

The second issue presents the question whether the payment of $12,500 was income to petitioner. According to the stipulated facts the complaining stockholders were paid $50,000 "in full settlement and discharge of the claims and cause of action of petitioner and the plaintiff stockholders as set forth in the complaint." How the sum was arrived at we do not know. Apparently it was a negotiated lump-sum settlement. Whether the defendants merely "bought their peace" we can only conjecture. It is noted that the payment did not go through the corporate treasury although the prayer of the complaint specifically asked that the defendants "be adjudged and decreed to pay into the treasury." The reason is obvious. If a judgment had been entered and payment had been made into the corporate treasury, the proceeds would have been applied first to the creditor's claims and nothing would have remained for the stockholders.

[fol. 89] On the record we are unable categorically to catalog and characterize the payment. We can not determine whether it was replacement of capital restoration of lost profits, compensation for damages suffered, nuisance value, or some other type of payment. In this situation we have no alternative to holding that petitioner, on whom rested the burden of proof, has not proved that the item was not income.

Decision will be entered under Rule 50.

Enter: ENTERED OCT 23 1943 (Seal)

THE TAX COURT OF THE UNITED STATES

WASHINGTON

[Same Title]

DECISION

Pursuant to the Court's Memorandum Findings of Fact and Opinion, entered October 23, 1943, the parties herein having filed an agreed recomputation of tax on December 15, 1943, it is

ORDERED AND DECIDED: That there are deficiencies in income tax for the calendar years 1936 and 1937 in the respective amounts of $109.95 and $5,957.86.

Enter:

(Signed) Ernest H. Van Fossan, Judge. (Seal.)

[fol. 90] IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

Docket No. 111621

[Title omitted]

PETITION OF LILLIAN BOEHM FOR REVIEW

To the Honorable the Judges of the Circuit Court of Appeals of the United States, for the Second Circuit:

Now comes Lillian Boehm, by her attorney, Louis Boehm, and respectfully shows:

I.

JURISDICTION

Petitioner's residence and place of business, 470 West End Avenue, New York City. Income tax return for calendar year 1937 was filed with the Collector of Internal Revenue, for the Second District of New York, and within the jurisdiction of this Court; that the Court in which review is sought is in the United States Circuit Court of Appeals for the Second Circuit.

[fol. 91] II

PRIOR PROCEEDINGS

Commissioner of Internal Revenue determined deficiency in the sum of $7,663.09 on April 21, 1942. Taxpayer filed appeal on June 22, 1942 with the Board of Tax Appeals. The case was tried before the Tax Court of the United States on June 14, 1943, and on October 23, 1943 the Tax Court of the United States promulgated its findings of fact and opinion, and on December 18, 1943 entered its decision wherein it was ordered and decided that there was a deficiency in the sum of $6,067.81.

III

Nature of Controversy

The nature of the controversy is two-fold. First, is the question whether petitioner's stock in The Hartman Corporation became worthless prior to 1937. Second is the question whether the sum of $12,500 received by petitioner in 1937 in connection with the settlement of an action brought by petitioner and other stockholders of The Hartman Corporation against the directors of The Hartman Corporation is income to petitioner, or is a reduction of the cost of her stock.

IV

Assignments of Error

The taxpayer avers that in the record and proceedings before the Tax Court of the United States, and in the opinion and final decision rendered and entered by the Tax Court of the United States, manifest error occurred and intervened to the prejudice of the taxpayer who is ag- [fol. 92] grieved thereby, and who now assigns errors hereinbelow set forth and each of them, which she avers occurred in said record, proceeding and final decision so rendered and entered by the United States Tax Court, and hereby petitions that the said decision of the Tax Court be reviewed by the United States Circuit Court of Appeals, that a transcript of the record be prepared in accordance with the law and with the rules of said Court and transmitted to the Clerk of said Court for filing and that appropriate action be taken to the end that the said errors hereinbelow set forth hereinafter complained of may be reviewed and corrected by said Court, and the taxpayer assigns as error the following acts and omissions of the Tax Court of the United States:

1. Failure to allow a deduction of $19,940 as a loss on stock of The Hartman Corporation in the year 1937.

2. Failure to determine that petitioner ascertained that in the year 1937 her stock in The Hartman Corporation became worthless.

3. Failure to find that prior to 1937 petitioner had a reasonable expectation that her stock in The Hartman Corporation was not worthless.

4. Finding that petitioner's stock in the Hartman Corporation became worthless prior to 1937.

5. Failing to find that the identifiable event which determined the fact and extent of petitioner's loss due to the worthlessness of the stock of The Hartman Corporation was the settlement of the Graham suit in 1937.

6. Finding that the evidence was insufficient to establish the petitioner's stock of The Hartman Corporation had any [fol. 93] value at the beginning of the year 1937, and became worthless during that year.

7. Failure to find the evidence sufficient to establish that petitioner's stock of The Hartman Corporation had some value at the beginning of the year 1937, and became worthless during that year.

8. Finding that the condition of The Hartman Corporation was hopeless prior to the year 1937.

9. Failure to find that the condition of The Hartman Corporation was not hopeless prior to the year 1937.

10. Finding that there was no evidence on which to base the conclusion that the Graham suit was an asset of any substantial value.

11. Failure to find that there was evidence on which to base a conclusion that the Graham suit was an asset of substantial value.

12. Finding that there was no evidence as to the merits of the Graham suit, the probability of recovery, the assurance of the collection of a judgment, and other essential factors.

13. Failure to find that there was evidence as to the merits of the Graham suit, the probability of recovery, the assurance of the collection of a judgment, and other essential factors.

14. Finding that all value had gone from the stock of The Hartman Corporation prior to 1937.

15. Failure to find that all value had not gone from the stock of The Hartman Corporation prior to the year 1937.

[fol. 94] 16. Finding that the payment of $12,500 in the year 1937 was income to petitioner.

17. Failure to find that the payment of $12,500 to petitioner in the year 1937 was not income to petitioner.

18. Finding that there was no evidence as to the manner in which the amount of the settlement was arrived at.

19. Failure to find that the amount of the settlement was arrived at in settlement of petitioner's causes of action as a stockholder.

20. Finding that if judgment had been entered in the Graham suit the proceeds have been applied first to creditors' claims, and nothing would have remained for the stockholders.

21. Failure to find that if a judgment had been entered in the Graham suit and payment had been made into the corporate treasury, something would have remained for the stockholders after the payment of creditors' claims.

22. Finding that the evidence was insufficient to determine whether the payment to petitioner was replacement of capital, restoration of lost profits, compensation for damages suffered, nuisance value, or some other type of payment.

23. Finding that the payment to the plaintiff stockholders in the Graham suit did not go through the corporate treasury because if a judgment had been entered in the Graham suit and payment had been made into the corporate treasury, the proceeds would have been applied first to the creditors' claims, and nothing would have remained for the stockholders.

[fol. 95] 24. Failure to find that the amount of $50,000 paid to the plaintiff stockholders in the Graham suit was not paid in settlement of the cause of action of the corporation, but was to compensate for, and was paid in settlement of the individual loss and damage suffered by the plaintiffs in the Graham suit, as stockholders of The Hartman Corporation, owing to the acts of the defendants set forth in the complaint, and that such settlement did not affect the cause of action of the Corporation, and that that was the reason payment was not made into the corporate treasury.

25. Failure to find that under the law the plaintiff stockholders in the Graham suit had an absolute right to make such settlement.

26. Failure to find that if the Graham suit had proceeded to trial and a judgment had been entered therein on the merits, that there was a reasonable prospect of such judgment being for a sum far in excess of the outstanding claims against The Hartman Corporation, and that there was a reasonable prospect that a substantial amount might have been left over for the stockholders.

27. Conjecturing that the defendants in the Graham suit in making the settlement merely bought their peace, and in finding that it could not be determined whether the sum of $12,500 paid to petitioner as her share of the settlement of the Graham suit was replacement of capital, restoration of lost profits, compensation for damages suffered, nuisance value, or some other type of payment.

28. Failure to find that the amount of $12,500 paid to petitioner was paid as compensation for damages sustained by her as a stockholder of The Hartman Corporation.

29. Finding that petitioner had failed to sustain the burden of proof that the payment to her was not income.

[fol. 96] 30. Failure to find the evidence sufficient to prove that the payment to petitioner was not income.

31. Failure to find that the cause of action against the directors of The Hartman Corporation was a valuable asset owned by the corporation, and that until said cause of action was disposed of by judgment or settlement it could not be determined whether petitioner's stock was worthless.

32. Failure to find that petitioner properly applied the amount received on the settlement from the cost of her stock, deducted the balance of $19,440 from her income as a loss on a worthless security.

33. Denial of petitioner's motion to reopen the record for the presentation and submission of further proof as to the following matters concerning which the Tax Court stated that the petition set forth insufficient facts to enable it to make a determination: (1) that the Graham suit was an asset of substantial value; (2) as to the merits of the Graham suit; (3) as to the probability of recovery; (4) as to the assurance of the collection of a judgment; (5) as to the financial worth of the defendants and their ability to

pay a recovery in excess of the outstanding claims against The Hartman Corporation; and (6) that the sum of $12,500 paid to petitioner was paid as compensation for damages.

Dated, New York, February 4th, 1944.

Lillian Boehm, Petitioner.

(Verified by Lillian Boehm on February 4, 1944.)

[fol. 97] AFFIDAVIT OF SERVICE—Filed February 24, 1944

STATE OF NEW YORK,
County of New York, ss:

Augusta M. Weissman, being duly sworn, deposes and says, that she is over the age of 18 years.

That on February 23, 1944, she served the Petition for Review and notice of filing thereof on the Respondent in the above matter, by mailing a copy thereof to J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, Washington, D. C.

(S.) Augusta M. Weissman.

Sworn to before me this 23 day of February, 1944.
(S.) Ruth G. Berman, Notary Public, New York County. N. Y. Co. Clk's No. 387, Reg. No. 451-B5. Commission Expires March 30, 1945.

[fol. 98] NOTICE OF FILING OF PETITION FOR REVIEW

To J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, Washington, D. C.:

You are hereby notified that the petitioner did on February 16th, 1944, file with the Clerk of the Tax Court of the United States at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Second Circuit of the decision of the Tax Court of the United States heretofore rendered in the above-entitled cause. A copy of the petition for review and assignments of error as filed is hereto attached and served upon you.

Dated, New York, February 24th, 1944.

(S.) Louis Boehm.

Personal service of the above and foregoing Notice, together with a copy of the Petition for Review and Assignments of Error mentioned therein is hereby acknowledged this — day of February, 1944.

———

[fol. 99] THE TAX COURT OF THE UNITED STATES

[Same title]

PRAECIPE FOR RECORD

To the Clerk of the Tax Court of the United States:

You are hereby requested to prepare and certify and transmit to the Clerk of the United States Circuit Court of Appeals for the Second Circuit, with reference to petition for review heretofore filed by the petitioner in the above cause, a transcript of record in the above cause, prepared and transmitted as required by law and by the rules of said Court, and to include in said transcript of record the following documents or certified copies thereof, to wit:

1. Docket entries of all proceedings before the Tax Court.

2. Pleadings before the Tax Court of the United States as follows:

(a) Petition filed June 22, 1942;

(b) Answer filed August 10, 1942;

(c) Motion for re-hearing to open the record for the presentation and submission of further evidence filed November 5, 1943.

3. Stipulation of facts and exhibits.

4. Findings of facts and opinion of the Tax Court of the United States.

5. Decision of the Tax Court.

[fol. 100] 6. Petition for review filed by petitioner in the above cause.

7. This Praecipe.

Louis Boehm, Attorney for Petitioner.

The within Praecipe approved this — day of ——, 1944.

—— ——, Attorney for Respondent.

[fol. 101] Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 102] UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT, OCTOBER TERM, 1944

No. 22

(Argued December 7, 1944. Decided January 11, 1945)

LILLIAN BOEHM, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Before Swan, Augustus N. Hand and Chase, Circuit Judges

Petition to Review a Decision of the United States Tax Court

The taxpayer seeks review of an order of the Tax Court determining a deficiency in income tax for the year 1937. Reversed and remanded.

Louis Boehm, attorney for petitioner. Bernard D. Fischman, of counsel.

Samuel O. Clark, Jr., Assistant Attorney General, Sewall Key, A. F. Prescott, and S. Dee Hanson, Special Assistants to the Attorney General, for respondent.

[fol. 103] SWAN, Circuit Judge:

In 1929 the taxpayer bought stock of The Hartman Corporation at a cost of $32,440. She claimed that this stock became worthless in the year 1937; and in the same year she received $12,500 as her share of a settlement of a stockholders' derivative action brought by her and other stockholders against directors and officers of the corporation. Accordingly, in her income tax return for 1937 she claimed a deduction of $19,940 as a loss sustained on her stock. The Commissioner denied the claimed deduction on the ground that the loss was not sustained in that year, and he included the $12,500 settlement recovery as taxable income. The Tax Court sustained both rulings. This appeal challenges their correctness.

The precise year in which a loss for worthless stock may be successfully claimed as a deduction in computing net income is always a troublesome question for a taxpayer. "Losses sustained during the taxable year and not com-

pensated for by insurance or otherwise" are allowable deductions, section 23(e) of the Revenue Act of 1936; but whether the loss on stock in a corporation which has become insolvent was "sustained" in the taxable year or some other year presents a question of fact frequently not easy of determination and upon which the taxpayer must carry the burden of proof. *Keeney* v. *Commissioner,* 116 F. 2d 401 (C. C. A. 2). The Tax Court found specifically that the petitioner's stock did not become worthless in 1937, and in its opinion stated that the evidence clearly shows that it became worthless prior to that year. This finding of fact can be reversed only if unsupported by substantial evidence. *Dobson* v. *Commissioner,* 320 U. S. 489; *Mahler* v. *Commissioner,* 119 F. 2d 869 (C. C. A. 2), cert. den. 314 U. S. 660. We cannot say there is no substantial support for it. In June 1932 equity receivers were appointed for the corporation; their report of August 10, 1934 showed outstanding [fol. 104] claims of $707,430.67 and assets of only some $39,000 in cash and the derivative stockholders' action above mentioned, which will be referred to hereafter as the *Graham* suit. In July 1935 the receivers filed a second report; it showed the cash to have been reduced to about $27,000, mentioned again the *Graham* suit and the same amount of outstanding claims, and recommended that claims totaling $630,574.57 be allowed and a dividend of 4 per cent. be paid thereon. The court adopted the report and its recommendations, and discharged one of the two receivers. The remaining receiver filed a final report and was discharged in September 1937. This report listed as the sole remaining asset cash in the amount of $1909.94. The *Graham* suit had been dismissed on stipulation in May 1937. That suit was instituted in December 1932 by the taxpayer and eight other plaintiffs on behalf of themselves and all other stockholders who might intervene. It charged the defendant directors and officers with waste, mismanagement and violation of their duties as fiduciaries, and prayed that they be required to account to the corporation and pay to it the loss and damage it sustained by reason of their wrongful acts. During the years 1933 to 1936, inclusive, extensive examinations were had of certain of the defendants, and the plaintiffs expended some $2,800, exclusive of attorney's fees, in connection with taking such testimony. Shortly before the case was to be reached for trial, the suit was settled. On February 20, 1937 the sum of $50,000 was paid by the de-

fendant directors in full settlement and discharge of the plaintiffs' claims. The taxpayer's share of the settlement, after payment of counsel fees and expenses, amounted to $12,500.

It is apparent from the receivers' reports of 1934 and 1935 that the corporation was hopelessly insolvent and its stock worthless, unless a recovery should be made in the *Graham* suit large enough to pay off creditors, whose allowed claims totaled some $630,000. The Tax Court thought [fol. 105] that not enough was shown to justify an inference that these claims would be paid. On this subject Judge Van Fossan's opinion says:

> "* * * We have no evidence on which to base a conclusion that the Graham suit was an asset of any substantial value. We know nothing of the merits of the suit, the probability of recovery, the assurance of the collection of a judgment, or other essential factors. The stipulated fact that the defendants were men of financial responsibility is not sufficient to establish the collectibility of a recovery equal to the outstanding claims. These claims aggregated more than half a million dollars and had to be satisfied before there would be anything for the stockholders. In our opinion, all value had gone from the stock prior to 1937."

Despite the huge damages, running into millions, which the complaint alleged the corporation had suffered from the directors' mismanagement, the Tax Court's inference of fact that the litigation would not produce enough to restore any value to the stock cannot be said to be so unreasonable as to justify setting it aside. Indeed, it finds support in the conduct of the taxpayer herself, whose income tax return for the year 1934 claimed a deduction (disallowed by the Commissioner) of $32,302 as a loss due to the worthlessness of her stock, thus indicating that she herself then inferred, despite the pending suit, that the stock became worthless in that year. See *Forbes* v. *Commissioner*, 62 F. 2d 571, 574 (C. C. A. 4). The fact that other stockholders did not intervene and that the equity receivers were not interested to prosecute the corporation's cause of action against its directors is also not without significance in appraising the probable value of this asset.

The petitioner argues that the definitive event which determined whether there would be a loss and, if there was, the [fol. 106] amount of it was the settlement of the *Graham* suit in 1937. Particular reliance is placed in *Morton* v. *Commissioner*, 104 F. 2d 534 (C. C. A. 4) for the proposition that the final settlement of litigation is "the determinative event which fixed the time of the loss." There a mortgage foreclosure sale of the taxpayer's property was had in 1932 and litigation involving the validity of the sale was settled in 1934. The taxpayer claimed his loss was sustained in the latter year, not in the year when the property was sold on foreclosure, and the court so held because the validity of the sale was not determined until the litigation ended. This principle is not applicable to the case at bar. Here there were identifiable events—receivership and the receivers' reports—which showed the stock to be utterly worthless, unless a stockholders' derivative action of unproven value should restore some 600,000 to the corporate treasury. The probability of such a result was too speculative to permit stockholders to postpone the taking of their losses until termination of the litigation. See *Young* v. *Commissioner*, 123 F. 2d 597, 599 (C. C. A. 2). Instead of being governed by *Morton* v. *Commissioner*, *supra*, the situation at bar is more analogous to that involved in *Niagara Share Corp.* v. *Commissioner*, 82 F. 2d 208 (C. C. A. 4), which the court cited and distinguished in the *Morton* opinion. In the *Niagara* case the taxpayer sustained a loss on the sale of securities in 1930, but had a claim against three individuals who had given a guaranty against the loss but denied liability on their guaranty. The court held that the loss should be taken in the year when suffered and the recovery, if any, accounted for in the year when litigation on the guaranty ended. In accord is our own decision in *Commissioner* v. *John Thatcher & Son*, 76 F. 2d 900. The case of *Sabath* v. *Commissioner*, 100 F. 2d 569 (C. C. A. 7), also relied upon by the petitioner, we regard as distinguishable on its facts. [fol. 107] The petitioner further argues that the question to be determined is not whether the stock actually became worthless before 1937 but whether she honestly believed that it had some value until settlement of the litigation. This court has approved the objective rather than the subjective test in determining the worthlessness of stock. *Squier* v. *Commissioner*, 68 F. 2d 25, 27; *Olds & Whipple* v. *Commissioner*, 75 F. 2d 272, 275; *Mahler* v. *Commissioner*,

119 F. 2d 869, 872, cert. den. 314 U. S. 660. In the *Mahler* opinion we said that a taxpayer must claim his deduction "in the year in which events are such as to furnish convincing evidence that the stock has in fact become worthless in that year." In so far as *Smith* v. *Helvering*, 141 F. 2d 529 (C. A. D. C.) adopts the subjective test we must respectfully disagree with it.

For the foregoing reasons we affirm the ruling that the loss was not sustained in 1937. But we are constrained to disagree with the ruling that the settlement payment of $12,500 should be included as taxable income to the petitioner. The Tax Court's opinion states:

> "On the record we are unable categorically to catalog and characterize the payment. We can not determine whether it was replacement of capital, restoration of lost profits, compensation for damages suffered, nuisance value, or some other type of payment. In this situation we have no alternative to holding that petitioner, on whom rested the burden of proof, has not proved that the item was not income."

In holding that the taxpayer had not proved that the payment was not income we think the court was in error. The complaint in the *Graham* suit charged that the defendant directors had acted illegally and in a manner destructive of the corporation and the rights of its stockholders, and to [fol. 108] its and their great damage. Clearly whatever the petitioner received in settlement was paid her as a stockholder and represented damages for destruction of the value of her stock caused by the allegedly illegal acts of the defendants. Since her stock had become worthless before 1937 and since she had never received any deduction from her gross income in any taxable year by reason of the loss of her investment in the stock, the sum she recovered in the settlement must be regarded as a capital item in reduction of her loss rather than as income. In *Estate of James N. Collins*, 46 B. T. A. 765, the Board of Tax Appeals under similar circumstances applied the so-called tax benefit principle and treated the compromise of litigation as resulting in capital gain rather than taxable income to the taxpayer, and its action was upheld in *Dobson* v. *Commissioner*, 320 U. S. 489. Uniformity of tax administration requires application of the same principle in the case at bar. Accordingly the decision is reversed and the cause remanded.

[fol. 107] [File endorsement omitted.]

[fol. 108] IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

[Title omitted]

PETITION FOR REHEARING—Filed February 5, 1945

To the Honorable Judges of the Circuit Court of Appeals of the United States, for the Second Circuit:

Now comes Lillian Boehm, by her attorney Louis Boehm and respectfully shows:*

I

The within appeal was argued before this Court on December 7, 1944, and decided on January 11, 1945. The Judges who concurred in the judgment of this Court were Circuit Judges Swan, Augustus N. Hand and Chase. Annexed hereto as Exhibit "A" is a copy of the opinion of this Court.

II

The within petition for rehearing is filed pursuant to Rule 27 of the Rules of the United States Circuit Court [fol. 109] of Appeals, for the Second Circuit. The time for filing the within petition for rehearing was extended by Circuit Judge Swan on January 25, 1945, to February 5, 1945.

III

Petitioner requests a rehearing of the within appeal insofar as the Court affirmed the decision of the Tax Court that petitioner's stock in the Hartman Corporation did not became worthless in the year 1937. Petitioner bases this application for a rehearing on four grounds:

1. This Court in its opinion stated that "the finding of fact" of the Tax Court as to the year in which petitioner's stock became worthless "can be reversed only if unsupported by substantial evidence." Petitioner respectfully

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* Unless otherwise indicated, emphasis is ours.

submits that where, as in the instant case, the entire record consists of an agreed statement of facts that the conclusion drawn by the Tax Court from the conceded facts constitutes a conclusion of law and not a determination of fact. Hence, this Court is respectfully requested to review the determination of the Tax Court as a determination of law.

2. This Court in its opinion stated that "the conduct of the taxpayer in claiming a deduction in her 1934 income tax return indicated that "she herself then inferred, despite the pending suit, that the stock became worthless" in 1934. Petitioner respectfully submits, for the reasons hereinafter set forth, that her attempt to deduct the loss in 1934 does not indicate that she believed her stock to be worthless in that year, and that furthermore, applying the "objective test" laid down by this Court in determining the value of the Graham suit, her opinion as to its value in any event would be immaterial.

3. This Court in its opinion stated that "the fact that other stockholders did not intervene" in the Graham suit [fol. 110] (which had been brought by petitioner and six other stockholders of the Hartman Corporation) was "not without significance in appraising the probable value" of the Graham suit. While it is true that other stockholders did not intervene in the Graham suit, nevertheless, it has no significance because (a) other stockholders of the Hartman Corporation petitioned the N. Y. Supreme Court, pursuant to Section 193, subdivision 2 of the Civil Practice Act, for permission to intervene in the Graham suit and said petition was denied; and (b) another derivative stockholders' action was brought in the New York Supreme Court by other stockholders, which action was likewise settled. Hence, in appraising the value of the Graham suit, the significant fact is that other stockholders did actually seek to intervene therein and that another group of stockholders commenced an independent action, which was likewise settled.

4. This Court in its opinion stated that the fact that "the equity receivers were not interested to prosecute the Corporation's cause of action against its directors is also not without significance in appraising the probable value of this asset (Graham suit)." While it is true that the equity receivers were not interested in prosecuting the Corporation's cause of action against its di-

rectors, nevertheless, that lack of interest was not due to lack of merit in the cause of action but to an entirely different circumstance. The equity receivers were Martin L. Straus and Elias Mayer (153). Martin L. Straus was the President and a director of Hartman and a defendant in the Graham suit. He could not, therefore, be expected to prosecute the Corporation's cause of action against himself. Elias Mayer, the equity co-receiver, was his lawyer, and likewise could not be expected to prosecute a cause of action against his client. In fact, Elias Mayer was a defendant in the other stockholders' action.

Each of these four grounds will be separately discussed.

[fol. 111] Point I

An appeal from a decision based entirely on an agreed statement of facts raises solely questions of law.

No evidence was presented before the Tax Court. The case was submitted on an agreed statement of facts (fols. 79 to 96 of the record). When a case is presented upon an agreed statement of facts there are no findings of fact by the Trial Court. We respectfully submit that the conclusion to be drawn from the agreed facts is a conclusion of law and not a finding of fact. With all due deference, it seems to us quite unrealistic to treat the opinion of a single judge of the Tax Court upon conceded facts as a determination of fact which this Court may not review. Surely, the single judge of the Tax Court has no method of determining the merits or value of a lawsuit superior to that of this honorable Court. We submit that when the facts are agreed upon there remains only the application of the law to the conceded facts, and that the resulting determination is a determination of law and not of fact.

In *Matter of Trowbridge*, 266 N. Y. 283, an analogous situation was presented. In the *Trowbridge* case, James A. Trowbridge died at Noroton, Connecticut on May 30, 1931. His will was probated in New York County and the question was as to whether the decedent had died a resident of New York or of Connecticut. The State of Connecticut submitted to the jurisdiction of the Surrogate of New York County and an agreed statement of fact was submitted to that Court.

The conceded facts were as follows: Mr. Trowbridge was born and educated in Connecticut but came to New

York in early manhood to engage in business, and resided there until 1904. After retirement from business, he purchased a residence in Connecticut which he made his domicile until 1921, when the house was destroyed by fire. He rebuilt the house and lived therein with his wife and son [fol. 112] until his death in 1931. After completion of the new building decedent's house in New York was unused and boarded up; telephone service was discontinued and furnishings and silver removed to the new home. After the year 1921 the decedent, however, continually characterized himself in tax returns and other writings as a resident of New York. He registered and voted in that city. His name was transferred to the resident tax roll for the Borough of Manhattan, and in affidavits and in his will he declared himself as a resident of New York. The Surrogate decided that the decedent had died a resident of New York. The Appellate Division unanimously affirmed this decision. On further appeal, the Court of Appeals reversed the decision and held, *as matter of law*, that decedent had been a resident of Connecticut. The conceded facts in the *Trowbridge* case were undoubtedly susceptible of two inferences. The Surrogate and the Appellate Division of the New York Supreme Court both drew the inference that Mr. Trowbridge had died a resident of New York. However, because none of the facts were disputed, the Court of Appeals went into the facts and, as *matter of law*, decided that he was a resident of Connecticut. At pages 288 and 289 the Court stated:

> "Mr. Trowbridge, however, had but one domicile when he died. What must be here decided is whether all the facts tending to show that his domicile was then in Connecticut conclusively overbalance all the facts tending to show that he was at that time domiciled in this State. In its nature such an analysis of the evidence is a comparison of one combination of facts with another and the significance of some of the factors involved is *as matter of law* greater than that of others."

And at page 293, the Court said:

> "Here, as we have said, all the primary evidentiary facts are admitted. We think that, upon the findings made below, the only inference admissible in *sound*

reason is that the domicile of Mr. Trowbridge at his death was at Noroton, Connecticut. It may be sug- [fol. 113] gested, of course, that by this disposition of the controversy we have imputed unreasonableness to the courts below because we disagree with them. Such a pleasantry has been dismissed before this. (Thayer, Cases on Evidence (2d ed.), p. 163.)"

The reason for this rule is likewise apparent. The respect and weight given to the trier of the facts who sees and hears the witnesses and passes upon their credibility is necessarily absent when there are no witnesses whose credibility is in issue and no disputed facts to be determined. In other words, there is no issue of fact when the facts are conceded. The conclusion to be drawn from the conceded facts then becomes a conclusion of law.

The rule is particularly applicable to the instant case, where the Circuit Court of Appeals, composed of three distinguished lawyers, possesses far greater skill in appraising the value of a lawsuit than a single judge of the Tax Court, who may be a layman. The year in which the petitioner's stock became worthless is dependent upon an appraisal of the Graham suit. There is no special skill or knowledge in a judge of the Tax Court which would qualify him to make an expert appraisal of the value of the Graham suit. Certainly, he is in no better position to judge the merits or value of this suit than is this honorable Court itself. As all the facts concerning the Graham suit are set forth in the stipulation of facts and the exhibits annexed thereto, this Court can determine for itself the merit and value of that suit.

We do not question the general rule of the *Dobson* case (*Dobson* v. *Commissioner*, 320 U. S. 489), which this Court cited, that findings of fact may be reversed only if unsupported by substantial evidence. We state merely that the rule is inapplicable where the facts are *conceded*. In such case we respectfuly submit that the determination below is not a determination of fact by which this Court is bound, but that this Court should review the case as presenting a [fol. 114] question of law as though submitted to it *de novo* on agreed facts. This was done in the *Trowbridge* case, *supra*, by the New York Court of Appeals (which may not review determinations of fact). Despite the fact that an opposite conclusion might be and actually was drawn

from the conceded facts by the courts below, it drew its own conclusion and reversed the lower courts *as matter of law.*

Point II

The attempted deduction by petitioner of her loss in the year 1934 does not support the inference that she then believed her stock to be worthless.

Petitioner attempted to deduct her loss on the stock of the Hartman Corporation in the year 1934. From this fact this Court inferred that petitioner then thought her stock to be worthless. However, this Court has recognized the dilemma in which taxpayers often find themselves and in *Young* v. *Commissioner*, 123 F. (2d) 597, 600, Judge A. N. Hand said:

> "In cases like this the taxpayer is at times in a very difficult position in determining in what year to claim a loss. The only safe practice, we think, is to claim a loss for the earliest year when it may possibly be allowed and to renew the claim in subsequent years if there is any reasonable chance of its being applicable to the income for those years."

Petitioner did no more than to adopt "the only safe practice" as sugested by this Court.

Furthermore, the inference (to which this Court referred at p. 688) that the taxpayer herself thought that the stock became worthless in 1934, because she attempted to take a deduction in that year, is contradicted by the conceded fact that she continued thereafter vigorously to [fol. 115] prosecute her lawsuit and to expend substantial sums of money thereon. But even assuming, for the sake of argument, that the taxpayer in 1934 feared that her stock had become worthless despite the lawsuit, this Court, in this very case, has held that the *objective* and not the subjective test of worthlessnes of an asset should be adopted, and that "insofar as *Smith* v. *Helvering*, 141 F. 2d 529 adopts the subjective test, we must respectfully disagree with it" (p. 690). Judged, therefore, by the "objective test," namely, what the *intrinsic merits* of the lawsuit were and not what the taxpayer thought about them, the fact that the taxpayer sought to deduct her loss in 1934 can have no bearing on the objective question of the intrinsic merit and value of the lawsuit.

Judging the lawsuit by the objective standards laid down by this Court, we must take into consideration the facts set forth in the complaint in the Graham case, *which have in no wise been contradicted before the Tax Court*, the amount of the damage which Hartman sustained as a result of the transactions set forth in the complaint, and the fact that if the case had gone to trial a judgment might have been obtained far in excess of the claims of creditors and enough to leave a substantial amount for the stockholders.

We respectfully submit that the best objective test of the merit and value of this lawsuit is to be found in the actual outcome of the suit. The settlement that was made with the taxpayer and the other stockholders was not a nominal, or nuisance value, settlement but a substantial settlement which netted to the taxpayer approximately 40% of the cost of her stock, after the payment of counsel fees and expenses. Is it reasonable to infer that the directors would have made such a substantial settlement had there been no merit to the suit? It seems to us that the only *sound* conclusion (which is a conclusion of law) [fol. 116] to be drawn from this fact, viewed objectively, is that the lawsuit was an asset of substantial value and that the worthlessness of taxpayer's investment in Hartman stock was not, and could not be, determined until the lawsuit was either tried or settled.

Point III

This honorable Court mistakenly assumed that the failure of other stockholders to intervene in the Graham suit was a significant fact in appraising the value of the Graham suit.

This Court stated that the fact that other stockholders did not intervene in the Graham suit was a fact not without significance. This Court, however, was not aware of the circumstance (a) that other stockholders sought to intervene in the Graham suit but were denied that privilege; and (b) that other stockholders commenced their own action in the New York Supreme Court against the directors of the Hartman Corporation, which action was also settled by the defendants at about the time that the Graham suit was settled. While it is true that these matters do not appear in the record, yet it is also true that the contrary does

not appear. Under the circumstances, therefore, we respectfully submit that this honorable Court was not justified in drawing the inference that other stockholders had not sought to intervene or to recover against the directors of Hartman for their mismanagement.

[fol. 117] Point IV

This honorable Court mistakenly assumed that the fact that the equity receivers were not interested to prosecute the Corporation's cause of action against its directors was a significant fact in appraising the value of the Graham suit.

This Court stated that the fact that the equity receivers were not interested to prosecute the Corporation's cause of action against its directors was likewise "not without significance in appraising the probable value of this asset" (p. 688). We believe that this Court was not aware of the identity and self-interest of the equity receivers in relation to the cause of action against the Hartman directors. The equity receivers were Martin L. Straus and Elias Mayer (Record, fol. 153). Martin L. Straus was the president, a director and the moving spirit of the Hartman Corporation, and a chief defendant in the Graham suit (Record, fols. 215, 221-224). He could not, therefore, be expected to prosecute the Corporation's suit against himself. Elias Mayer was Straus's lawyer and it would be unreasonable to expect that he would prosecute a cause of action against his own client. In fact, Elias Mayer was a defendant in the other stockholder's action instituted in the New York Supreme Court, which was likewise settled.

As was stated by the Court in *Norman* v. *Federal Mining & Smelting Co.*, 180 App. Div. 325, at p. 335:

> "It is not to be assumed that they (the directors) would prosecute in good faith an action based on their own misconduct."

Hence, the fact that the equity receivers were not interested in prosecuting the corporation's cause of action against the directors is readily understandable, and wholly without significance in appraising the value of the Graham suit.

[fol. 118] IV

Wherefore, petitioner respectfully prays that this Court grant a rehearing of her appeal on the issue of the year in

which her stock in The Hartman Corporation became worthless.

Dated, New York, February 1, 1945.

Lillian Boehm, Petitioner.

[fol. 119] *Duly sworn to by Lillian Boehm. Jurat omitted in printing.*

[fol. 120] CERTIFICATE OF COUNSEL

Louis Boehm certifies:

1. That he is the attorney for the petitioner-appellant in in the above entitled appeal.

2. The within motion for a rehearing is well founded in law and is not made for the purpose of delay.

Dated, New York, February 2, 1945.

Louis Boehm.

[fol. 123] UNITED STATES CIRCUIT COURT OF APPEALS, FOR THE SECOND CIRCUIT

LILLIAN BOEHM, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Before: Swan, Augustus N. Hand and Chase, Circuit Judges

Petition for Rehearing

Louis Boehm, attorney for petitioner.

Per CURIAM:

Petition for rehearing is denied.

T. W. S., A. N. H., H. B. C., C. JJ.

Filed February 7, 1945.

[fol. 124] UNITED STATES CIRCUIT COURT OF APPEALS, SECOND CIRCUIT

At a Stated Term of the United States Circuit Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the 7th day of February one thousand nine hundred and forty-five.

Present Hon. Thomas W. Swan, Hon. Augustus N. Hand, Hon. Harrie B. Chase, Circuit Judges.

LILLIAN BOEHM, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

A petition for a rehearing having been filed herein by counsel for the petitioner,

Upon consideration thereof, it is ordered that said petition be and hereby is denied.

Alexander M. Bell, Clerk.

[fol. 125] [Endorsed:] United States Circuit Court of Appeals, Second Circuit. Lillian Boehm, v. Commissioner of Internal Revenue. Order. United States Circuit Court of Appeals: Second Circuit. Filed Feb. 7, 1945. Alexander M. Bell, Clerk.

[fol. 126] UNITED STATES CIRCUIT COURT OF APPEALS, SECOND CIRCUIT

At a Stated Term of the United States Circuit Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the 10th day of February one thousand nine hundred and forty-five.

Present: Hon. Thomas W. Swan, Hon. Augustus N. Hand, Hon. Harrie B. Chase, Circuit Judges.

LILLIAN BOEHM, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Appeal from The Tax Court of the United States

This cause came on to be heard on the transcript of record from The Tax Court of the United States, and was argued by counsel. On consideration whereof, it is now hereby ordered, adjudged, and decreed that the order of said The Tax Court of the United States be and it hereby is reversed and cause remanded in accordance with the opinion of this court.

It is further ordered that a Mandate issue to the said The Tax Court of the United States in accordance with this decree.

Alexander M. Bell, Clerk.

[fol. 127] [Endorsed:] United States Circuit Court of Appeals, Second Circuit. Lillian Boehm, v. Commissioner of Internal Revenue. Order for Mandate. United States Circuit Court of Appeals: Second Circuit. Filed Feb. 10, 1945. Alexander M. Bell, Clerk.

[fol. 128] Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 122] SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed June 11, 1945

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit is granted, and the case is transferred to the summary docket.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

(9466)

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Supreme Court of the United States

OCTOBER TERM—1944

No. 254 69

LILLIAN BOEHM,

Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI AND BRIEF IN SUPPORT THEREOF

LOUIS BOEHM,
Attorney for Petitioner.

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Supreme Court of the United States

OCTOBER TERM—1944

No. .....

LILLIAN BOEHM,

Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI

To the Honorable, the Chief Justice and the Associate Justices of the Supreme Court of the United States:

The undersigned, on behalf of the above named petitioner, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals, for the Second Circuit, entered in the above case on February 10, 1945, modifying the order of The Tax Court of the United States which determined the presence of a deficiency in the 1937 income tax return of petitioner.

Summary Statement of the Matter Involved

There are no facts in dispute. No evidence was presented before The Tax Court. The case was submitted on an agreed statement of facts (79-96*), and therefore presents only a question of law.

* Parenthetical references are to folio numbers unless otherwise noted.

In 1929 taxpayer bought stock of The Hartman Corporation at a cost of $32,440 (80-81). In June, 1932 equity receivers were appointed for the Corporation (81). In December, 1932 taxpayer and eight other stockholders instituted a derivative stockholders' action against the directors requesting an accounting for their misconduct (88, 252). From 1933 to 1936 the action was vigorously prosecuted and substantial disbursements were incurred by taxpayer and the other plaintiffs (88-90). In February, 1937 the suit was settled for $50,000 (91). Taxpayer's share of the settlement, after payment of counsel fees and expenses, amounted to $12,500. In her income tax return for 1937 she claimed a deduction from gross income in the amount of $19,940, being the difference between $32,440, the cost of the stock, and $12,500, the amount of her recovery, as a loss due to the worthlessness of her Hartman stock. This loss was denied by the Commissioner. His action was upheld by the Courts below.

The Tax Court of the United States rendered an opinion (241-266) on October 23, 1943, and entered its order on December 18, 1943.

This Court Has Jurisdiction

The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code as amended by the Act of February 13, 1925 (U. S. C. A. Title 28, Section 347a). The judgment of the Circuit Court of Appeals was entered February 10, 1945 (p. 122). This petition, presented within three months after the entry of the aforesaid order, is timely.

The decision of the Circuit Court of Appeals in this case is in direct conflict upon a question of Federal law with the decision of the United States Court of Appeals for the District of Columbia in *Smith* v. *Helvering*, 141 F. 2d,

529. The Court below, in its opinion, said:

> "The petitioner further argues that the question to be determined is not whether the stock actually became worthless before 1937 but whether she honestly believed that it had some value until settlement of the litigation. This court has approved the objective rather than the subjective test in determining the worthlessness of stock. (Citing cases.) In the *Mahler* opinion we said that a taxpayer must claim his deduction 'in the year in which events are such as to furnish convincing evidence that the stock has, in fact, become worthless in that year.' In so far as *Smith* v. *Helvering*, 141 F. 2d 529 (C. A. D. C.) adopts the subjective test we must respectfully disagree with it" (R. pp. 105-106).

In *Smith* v. *Helvering*, 141 F. 2d 529, the Court of Appeals for the District of Columbia, applied the "subjective test," namely, the honest belief of the taxpayer as evidenced by his conduct, and held that the year in which the *taxpayer* actually ascertained the stock to be worthless was the determining factor.

Thus, the question presented is whether the *objective* test, that is, the test based upon worthlessness in the light of subsequent events (in other words, hindsight), or the *subjective* test (that is, the test based upon what the taxpayer actually thinks at the time and acts upon) is to be used to determine the year in which stock is worthless for the purpose of deducting taxpayer's loss.*

---

* The pertinent statute and regulations involved are printed in the appendix to the brief in support of the within petition. In *Helvering* v. *N. Y. Trust Co.*, 292 U. S. 455, it was held that subsequent changes in the taxing statute were unimportant on the issue of whether a writ should be granted. In fact, however, the same question presented herein arises under the present tax statutes.

Reasons for Granting the Writ

The decision of the Circuit Court of Appeals is in direct conflict, on a question of Federal law, with the decision of the United States Court of Appeals for the District of Columbia in *Smith* v. *Helvering,* 141 F. 2d 529. In the instant case the Court held that the *objective* test was to be used in determining the year in which stock became worthless. In *Smith* v. *Helvering,* the United States Court of Appeals for the District of Columbia, held that the *subjective* test was to be used. In the instant case, the Circuit Court of Appeals specifically refused to follow the decision of the United States Court of Appeals for the District of Columbia.

WHEREFORE, it is respectfully submitted that this petition for a writ of certiorari to review the judgment of the Circuit Court of Appeals for the Second Circuit, should be granted.

Dated, New York, May 9, 1945.

LOUIS BOEHM,
Attorney for Petitioner.

Supreme Court of the United States

OCTOBER TERM—1944

No. . . . . .

LILLIAN BOEHM,

Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

BRIEF IN SUPPORT OF PETITION

The Opinions Below

The memorandum opinion of The Tax Court of the United States (241-266) is not reported. The opinion of the Circuit Court of Appeals (pp. 102-106) is reported in 146 F. 2d 553.

Jurisdiction

The relevant facts with regard to the jurisdiction of this Court are stated in the petition.

The conflict between the decision of the Circuit Court of Appeals in this case and the Court of Appeals for the District of Columbia in *Smith* v. *Helvering*, 141 F. 2d 529, is set forth in the petition.

In *Jurisdiction of the Supreme Court of the United States* by Robertson and Kirkham, the authors at page 676, Sec-

tion 327, state the rule thus:

> "Conflicts of decision between the Court of Appeals for the District of Columbia and the Circuit Courts of Appeals, occurring generally in cases involving federal taxes, are grounds for the issue of the writ either to the District of Columbia Court of Appeals or the Circuit Courts of Appeals." (Citing *Helvering* v. *Grinnell*, 294 U. S. 153, *British-American Tobacco Co.* v. *Helvering*, 293 U. S. 95, and Porter v. Commissioner of Internal Revenue, 288 U. S. 436.)

Statement of the Case

In 1929 the petitioner purchased 1,100 shares of the Class A stock of The Hartman Corporation, hereinafter called Hartman, for $32,440. Hartman was incorporated in 1916 in the State of Virginia and acquired the capital stock of the Hartman Furniture and Carpet Company, hereinafter referred to as Hartman (Illinois), and its affiliates, which were engaged in the business of selling furniture, carpets and household goods (80-81, 244-245).

On December 31, 1931, Hartman had total current assets as shown by its consolidated balance sheet of $8,978,091.22, and total assets of $15,401,097.97; current liabilities of $4,198,813.26, plus other miscellaneous liabilities, making total obligations of $4,740,438.47, leaving a net worth of $9,410,659.59, in addition to a reserve for contingencies of $1,250,000 (178-186).

On May 4, 1932 Hartman advised its stockholders that borrowed moneys had been reduced by $575,000 since January 1, 1932, thereby reducing borrowed moneys to a new low since 1924 (192).

In June, 1932, Martin L. Straus and Elias Mayer were appointed equity receivers for Hartman by the U. S. District Court for the Northern District of Illinois, Eastern Division. The receivers entered into possession of the

property of Hartman and continued its business of buying and selling furniture and other household articles from the time of their appointment until on or about May 26, 1933 (81, 245).

The bill of complaint requesting the appointment of equity receivers for Hartman alleged that the corporation's assets were greater than its liabilities, but that it was temporarily unable to meet its current obligations, and that by reason thereof, it prayed for the protection of a court of equity and the appointment of equity receivers to take possession of its property and assets, and to continue its business of buying and selling furniture and other household goods (106, 121, 131).

In the bill of complaint in said action, it was further alleged "that said assets upon thus being administered in a court of equity, through said receivership, will be sufficient to pay in full all liabilities against said defendant, and that a surplus will be left for the benefit of defendant's stockholders" (131-132). These allegations of the bill of complaint were admitted to be true by Hartman (152).

A suit against the directors, hereinafter called the Graham suit, was instituted on December 16, 1932 in the New York Supreme Court. The petitioner and eight other stockholders of Hartman were plaintiffs. The defendants were the corporation, Hartman, and nine directors. The plaintiffs brought the suit "on behalf of themselves as stockholders of the Hartman Corporation and on behalf of the said Company and all other stockholders of said Company similarly situated, who may join with the plaintiffs in, and contribute to the expenses of, this suit" (88, 252). The complaint charged the defendants with waste and mismanagement and demanded that the defendants render an accounting and pay into the treasury of the corporation the amount of the loss and damage sustained by it by reason of their wrongful acts (225-226, 253).

More specifically, the complaint alleged that during the years 1929 and 1930 the directors and officers of Hartman caused it to purchase in the open market for cash, 64,789 shares of its Class B, or junior, stock at an average cost of $22 per share and at an aggregate cost of $1,422,000 (227). The complaint alleged that part of this Class "B" stock was purchased by the corporation from the individual directors and officers (230). It was also alleged that the directors, without the knowledge of the stockholders, caused the corporation thereafter to sell the Class "B" stock to its employees (including its officers and directors), at a price of $16 per share, $6 per share less than the cost of the stock, with an agreement by the corporation to repurchase the stock, *at the option of the officers, directors and employees,* at the cost to them. Thereafter, the stock became worthless. The corporation repurchased large amounts of the stock at the price of $16 per share, and then retired the stock (231-232). The entire amount of $1,422,000 expended for the stock was lost (227-233).

It is interesting to compare the corporation's loss on 64,879 shares of stock aggregating $1,422,000 with the total liabilities of the corporation amounting to $630,574 (250) at the termination of the equity receivership. The recovery on this single element of wrongdoing, exclusive of all other acts of mismanagement, would have been more than twice the total of all the liabilities of the corporation. This conclusively demonstrates that a substantial equity remained for the stockholders in the cause of action against the directors.

In 1933 a new corporation called Hartman's, Inc., was organized under the laws of the State of Delaware. As of May 26, 1933 Hartman's, Inc. purchased at a bankruptcy sale the assets of Hartman (Illinois), the wholly owned subsidiary of Hartman, for the sum of $501,000 in cash and an agreement to procure a waiver of certain inter-company claims against the bankrupt estate. The stock of the new

company was issued to the creditors of Hartman (Illinois) in settlement of claims, and to the stockholders of Hartman by subscription thereto. The stockholders of Hartman were given the right to subscribe for debentures and stock of Hartman's, Inc. in 1933 (196-208). Petitioner did not exercise this right of subscription (82-84, 247-248).

On August 10, 1934, the receivers of Hartman filed a report with the court listing as assets $39,593.13 in cash and *a suit pending against the directors* (the Graham suit), and as liabilities total outstanding claims amounting to $707,430.67. The receivers recommended that claims totalling $630,574.57 be allowed (84-85, 248). The receivers filed a second report on July 11, 1935, listing as assets $27,192.51 in cash *and the Graham suit pending against the directors,* and as liabilities the aforesaid claims. The receivers recommended that a dividend of 4 per cent be paid on the claims of $630,574.57 allowed, which was paid (86, 249).

During the years 1933 to 1936, inclusive, in connection with the prosecution of the Graham suit, examinations before trial of certain of the directors were held from time to time in New York City. Petitioner's counsel also went to Chicago, Illinois, during this period and spent four days there on the examination before trial of certain of the defendants who resided in that City (88-89). In the course of such examinations before trial, many hundreds of pages of testimony were taken and numerous exhibits were offered in evidence (89). Petitioner and the other plaintiff stockholders were ordered by the New York Supreme Court to pay the counsel fees, transportation and hotel expenses of the *defendant's* New York counsel who traveled to Chicago and represented said defendants on such examinations (90). Such counsel fees and expenses of defendants' counsel amounted to approximately $800 (89). Petitioner and the other plaintiff stockholders also paid the transportation and hotel expenses of their own counsel in attending upon such examinations, and also paid the fees

of the stenographer who took down and transcribed the testimony of such defendants, and also paid the fees of the commissioner before whom the examinations were held (90). Petitioner and other plaintiff stockholders also paid for the cost of printing briefs in the Appellate Division of the New York Supreme Court on an appeal which defendants had taken to such Court (90). The amount of disbursements paid by petitioner and the other plaintiff stockholders, exclusive of the fees of their own counsel, amounted to approximately $2,000 (90).

At the conclusion of the examinations and shortly before the trial, negotiations were commenced for a settlement of the action, and on February 20, 1937 such settlement was consummated. Under its terms the defendants directors paid the petitioner and the other plaintiff stockholders the sum of $50,000 in full settlement and discharge of the claims and cause of action of the petitioner and her co-plaintiffs. In connection with the settlement the petitioner and the other stockholders released all their rights and claims arising out of the acts committed by the defendants as alleged in the complaint. The suit was thereafter dismissed on May 14, 1937 (91, 257-258).

After the settlement of the Graham suit the receiver filed a final report with the court on September 30, 1937, and he was thereafter discharged by an order dated September 30, 1937 (86-87, 250).

Petitioner's proportionate share of the $50,000, after payment of counsel fees and expenses, amounted to $12,500. In her income tax return for 1937 she claimed a deduction from gross income in the amount of $19,940, being the difference between $32,440, the cost of the stock, and $12,500, the amount of her recovery, as a loss due to the worthlessness of her Hartman stock. The respondent denied the deduction and included in her gross income for that year the sum of $12,500 which she received pursuant

to the settlement (92-94, 258-259). The Circuit Court of Appeals held that the $12,500 constituted a partial recovery of the cost of the taxpayer's stock and was, therefore, not taxable as income. However, it held that the balance of $19,940, representing the unrecovered cost, was a loss which could not be deducted in 1937.

Specification of Errors

The errors which the petitioner will urge, if the writ of certiorari is allowed, are that the Circuit Court erred in holding that the *objective* test was solely to be used in determining the year in which stock became worthless, and that the taxpayer's honest belief, as shown by her conduct in vigorously prosecuting the Graham suit to a successful conclusion in 1937, was not to be considered.

Summary of Argument

The Circuit Court of Appeals in the instant case refused to follow the rule in *Smith* v. *Helvering,* 141 F. 2d 529, which held that the *subjective* test was to be employed in ascertaining the year in which stock became worthless, and a conflict exists between the Circuit Court of Appeals, Second Circuit, and the United States Court of Appeals for the District of Columbia on an important question of tax law, which should be resolved by this honorable Court.

POINT I

Petitioner in good faith believed that her stock had value until 1937 when the Graham suit was settled. Upon the settlement, petitioner executed general releases to the directors and the stock ceased to have further value.

We respectfully submit that taxpayer's honest belief that her stock had a value until 1937 (when she released the directors from liability and recovered $12,500 as her proportionate share of the settlement) entitles her to deduct the loss from her 1937 income.

It was stipulated in the Tax Court that extensive services were rendered in the prosecution of the Graham suit over a period of four years from 1933 to 1937 (88-92). Petitioner's counsel spent four days in Chicago in examining certain defendants who resided in that city (88). Certain of the defendants were examined in New York (89). Many hundreds of pages of testimony were taken and numerous exhibits offered (89). Petitioner and the other complaining stockholders were required to, and did pay, the fees of various New York counsel for defendants in attending the examinations in Chicago, as well as their traveling and hotel expenses, and those of their own counsel (89). They paid the fees of the Commissioner before whom the depositions were taken, as well as those of the stenographer who took them (90). They paid for the printing of briefs in an appeal to the Appellate Division of the New York Supreme Court. Petitioner and her co-plaintiffs paid disbursements of approximately $2,000, exclusive of counsel fees, in the prosecution of the action (88-90). Petitioner's good faith and confidence in the litigation which she had brought against the directors was attested by the payment of substantial disbursements incurred in the prosecution of the action, as well by her willingness to incur substantial

counsel fees for her own counsel in connection with the extensive services rendered.

Under these circumstances, we respectfully submit that petitioner should have been permitted to deduct her loss on the stock in the year in which she believed it to be worthless. In *Smith* v. *Helvering*, 141 Fed. (2d) 529, which the Court below specifically refused to follow, the United States Court of Appeals for the District of Columbia clearly ruled that the taxpayer's opinion and belief as evidenced by his acts are decisive of the year in which a worthless stock loss should be deducted.

In *Smith* v. *Helvering, supra*, the Commissioner determined a deficiency against the taxpayer for the calendar year 1937. The taxpayer deducted a loss on certain stock of San-i-Sal Laboratories, Inc., in the year 1937. It was shown that the corporation's business was suspended early in 1929 and that thereafter it had no full time employees and filed no Federal income tax return. It was shown that from 1925 to 1937 the petitioner advanced funds on behalf of the corporation. In 1937 a Certificate of Dissolution was filed with the Secretary of State of Delaware. It was not disputed that the corporation was insolvent prior to 1937. The Board of Tax Appeals stated that "the loss must be taken in the year in which it was sustained and at no other time" and this means the year in which these shares in every substantial and realistic way became worthless. In reversing the Board of Tax Appeals, the Court, per Justice Miller, stated at page 530:

> "We think the decision of the Board too severely restricted the taxpayer and sets too high a standard of industrial performance; especially in light of the remarkable industrial developments often achieved by courageous and optimistic American businessmen, who refused to be dissuaded when bankers and other conservative citizens advised that their enterprises were worthless in 'every substantial and realistic way.' Henry Ford is a striking example. Even though,

perhaps, a businessman should not be encouraged to be an incurable optimist, if he is one, nevertheless, and continues to express his optimism by putting money into an insolvent organization, he should be given the benefit of the doubt. This would seem to be particularly true where, as here, the suspension of business occurred in 1929, the year of the great panic, and the transfusions administered by the taxpayer occurred during the period of the most severe depression ever experienced in this country.

"The case which comes closest in its facts to the present case is *Rassieur* v. *Commissioner* [129 F. 2d 820]. The nub of the decision appears in the following language: 'So long as taxpayer was willing to protect or pay the company debts and to advance funds for its current expenses, no one could say that any "identifiable events" had occurred which finally determined the worthlessness of the stock.' The language of that opinion which immediately precedes the statement quoted is remakably apt: 'The panic struck this, as all other business, like a blight. Its business decreased and its owned securities diminished drastically in market value while expenses and indebtedness continued. In the endeavor to weather the storm and continue the business, various steps were taken, such as progressive restriction of business, curtailment of expenses, and sale of the "market service." It is evident that there was no time from 1931 to dissolution when it could have converted its assets, paid its debts and had anything remaining for stock value if it had been compelled to rely only upon its own resources and to liquidate. From the latter part of 1931, it could not have continued in business or paid its debts when due if it had been compelled to rely solely upon its own resources. However, the actual fact was that it did not have to so rely on its own resources alone. While there was neither legal nor moral obligation so to do, yet there were strong reasons of self-interest and probably of sentiment (help to his son) which impeled Theodore Rassieur to come to the financial aid of the company and he did so. The sole purpose of these two reasons was the same—to preserve the business. Unless that could be done, the taxpayer stood

to lose at least the $250,000 he had contributed (for himself and the two others) to the capital stock; and his son would be out of business. The mere winding up of this business would have defeated the purpose entirely. There can be no question that this purpose to preserve the business was the dominant moving consideration of these three men, who held all of the capital stock, during this entire period. The accomplishment of the purpose depended entirely upon the willingness of taxpayer to make advances. As long as he continued willing, the business would last. As long as it lasted, there was a prospect of its successful survival.'"

The Court then specifically held that the test that should be applied in determining the year in which the stock became worthless was a *subjective* and not an *objective* standard. The Court said, at p. 531:

"The test proposed by the Board in the present case is a highly objective one which disregards what the taxpayer may think of his investment, how much of an optimist he may be, or what he may consider to be the possibilities of future successful operation, or of eventual recoupment. An examination of the cases persuades us that the subjective appraisal of the taxpayer is of much greater importance. The Supreme Court said as much in *United States* v. *S. S. White Dental Manufacturing Company* [274 U. S. 398]. In *Forbes* v. *Commissioner*, Judge Parker, speaking for the Court of Appeals of the Fourth Circuit and reversing a decision of the Board in a similar case used the following language: 'Practical considerations must govern, for it is as true here as in Lucas v. American Code Co., 280 U. S. 445, 449, * * * that: "No definite legal test is provided by the statute for the determination of the year in which the loss is to be deducted. The general requirement that losses be deducted in the year in which they are sustained calls for a practical, not a legal test." * * * As said by Judge Learned Hand in de Loss v. Commissioner (C. C. A. (2d) 28 F. (2d) 803, 804), "So far as *human foresight* could go, the shares were worthless, and the petitioner might have

deducted the loss." We are not dealing with a case where *there was hope* that a business although involved *might be saved* and value in the stock established. *Hope* had been abandoned and *liquidation had been ordered.*' (Italics supplied.) In *Lucas* v. *American Code Company,* the Supreme Court pointed out that the test which should be applied is a practical and not a legal one. In that case the loss which was paid by the taxpayer in 1923 resulted from a breach of contract which occurred in 1919. The Court upheld a determination of the Board that the deduction could not be taken in 1919 because of the various possibilities which then existed affecting the amount of the recovery which might be, eventually, obtained against the company. Among other things the Court listed, as evidencing the attitude of the taxpayer, that it did not accrue on its books during the tax year of 1919 any liability in the estimated amount of the loss; and that reserves set up by the taxpayer during that year bore no relation to the apprehended loss. The Court concluded by saying: 'It cannot be said that the loss actually paid by the Company in 1923 was, as a matter of law or of undeniable fact, sustained in 1919. *Nor did the Company so regard it.*' (Italics supplied.) If the taxpayer's attitude is a proper subject of appraisal in one case it should be in another. Similarly, in *Benjamin* v. *Commissioner* [70 F. 2d 719], a subjective test was applied. It was held that the mere shutting down of a mill and suspension of business—other than prospecting for additional soapstone deposits—was not sufficient to show a complete loss; and this in spite of the fact that no deposits were actually uncovered. The court held that while *hope* and *possibility of success* remained, proof of loss was not complete. In the present case, if we reason from the taxpayer's attitude, hope had not been abandoned and possibility of success remained."

In the instant case, the petitioner did not believe that her stock was worthless prior to 1937. No other inference can be drawn from the conceded facts. Petitioner and the other stockholders who were plaintiffs in the Graham suit

employed counsel and advanced substantial sums of money in prosecuting what they considered a meritorious cause of action on behalf of the corporation. Expenditures, exclusive of counsel fees, amounted to approximately $2,000. Would the petitioner and the other plaintiff stockholders have spent at least $2,000 for disbursements, exclusive of counsel fees, in prosecuting a cause of action had they considered the stock worthless? So long as the petitioner spent substantial sums of money in asserting her rights as a stockholder, we do not believe it can be reasonably asserted that she believed her stock to be worthless.

We do not contend that the *subjective* test should be based merely upon the unsupported opinion or belief of the taxpayer. We do contend, however, that where there is a reasonable basis for the taxpayer's belief that his stock has not become worthless and that opinion is confirmed by affirmative conduct on the part of the taxpayer which is irreconcilable with a contrary conclusion, then we respectfully submit that the *subjective* test as to when the stock has become worthless is the proper test to be applied. This is particularly true when, as in the instant case, *the taxpayer's opinion was by the actual course of events demonstrated to be correct.* The recovery by the taxpayer, and the other plaintiffs in the Graham suit, of the sum of $50,000 in 1937 demonstrates the correctness of the taxpayer's opinion that her stock had not become worthless prior to that year.

We respectfully submit, in view of the direct conflict between the decision of the Circuit Court of Appeals in this case and the decision of the Court of Appeals of the District of Columbia in *Smith* v. *Helvering* (*supra*), it is essential in the public interest that the law on this disputed question shall be finally settled by this honorable Court. Unless this is done, the administration of the tax law on the difficult and important question when a worthless security loss should be taken will remain in doubt and

confusion, and taxpayers will be unable to determine just when they should take their losses in connection with worthless securities. We respectfully submit, therefore, that it is a matter of public importance that this honorable Court should grant a writ of certiorari herein and determine, once and for all, the law of the land in respect to what the Court below itself has said is a "troublesome question."

CONCLUSION

For the reasons heretofore assigned, it is respectfully submitted that the case is one which justifies the issuance of a writ of certiorari.

Respectfully submitted,

LOUIS BOEHM,
Attorney for Petitioner.

Appendix

Revenue Act of 1936, c. 690, 49 Stat. 1648:

* * * * * * *

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * * * *

(e) Losses by Individuals.—In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

* * * * * * *

(2) if incurred in any transaction entered into for profit, though not connected with the trade or business;

* * * * * * *

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

ART. 23 (e)—1. Losses by individuals.—Losses sustained by individual citizens or residents of the United States and not compensated for by insurance or otherwise are fully deductible if * * * (b) incurred in any transaction entered into for profit, or * * * (d) if not prohibited or limited by any of the following sections of the Act: * * * section 117, relating to limitation on losses recognized by section 112 upon the sale or exchange of capital assets; * * *

In general losses for which an amount may be deducted from gross income must be evidenced by closed and completed transactions, fixed by identifiable events, bona fide and actually sustained during the taxable period for which allowed. Substance and not mere form will govern in determining deductible losses. * * *

ART. 23 (e)—4. Shrinkage in value of stocks.—A person possessing stock of a corporation can not deduct from gross income any amount claimed as a loss merely on account of shrinkage in value of such stock through fluctuation of the market or otherwise. The loss allowable in such cases is that actually suffered

when the stock is disposed of. If stock of a corporation becomes worthless, its cost or other basis as determined and adjusted under section 113 is deductible by the owner for the taxable year in which the stock became worthless, provided a satisfactory showing is made of its worthlessness. * * *

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Supreme Court of the United States

OCTOBER TERM, 1945

No. 69

LILLIAN BOEHM,

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v.

COMMISSIONER OF INTERNAL REVENUE.

PETITIONER'S BRIEF

LOUIS BOEHM,
Attorney for Petitioner.

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STATUTE

Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925 (U.S.C.A. Title 28, Section 347a) 1, 2

Supreme Court of the United States

OCTOBER TERM, 1945

No. 69

LILLIAN BOEHM,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE.

PETITIONER'S BRIEF

Petitioner herein, the above named Lillian Boehm, presents for review the judgment of the U. S. Circuit Court of Appeals, for the Second Circuit, entered in the above case on February 10, 1945 (92) modifying the order of the Tax Court of the United States (68-69) which determined the presence of deficiencies in her 1936 and 1937 income tax returns.*

Opinions Below

The opinion in the Tax Court of the United States (62-68) is not officially reported. The opinion in the Circuit Court of Appeals is reported in 146 F. 2d 553.

Statement of Jurisdiction

The judgment of the Circuit Court of Appeals was entered February 10, 1945 (92). The jurisdiction of this Court was invoked under Section 240 (a) of the Judicial

* Figures in parenthesis refer to the pages of the printed transcript of record. Unless otherwise indicated, emphasis is ours.

Code as amended by the Act of February 13, 1925 (U.S. C.A. Title 28, Section 347a).

Certiorari was granted by this Court on June 11, 1945 on petitioner's application.

Statement of Case

The case having been submitted on an agreed statement of facts (20-24), no facts are in dispute.

In 1929 the petitioner purchased 1,100 shares of the Class A (or preferred) stock of The Hartman Corporation, an old established furniture house, hereinafter called Hartman, for $32,440 (20). On December 31, 1931, Hartman had total current assets as shown by its consolidated balance sheet of $8,978,091.22, and total assets of $15,401,097.97; current liabilities of $4,198,813.26, plus other miscellaneous liabilities, making total obligations of $4,740,438.47, leaving a net worth of $9,410,659.59, in addition to a reserve for contingencies of $1,250,000 (45-47). On May 4, 1932 Hartman advised its stockholders that borrowed moneys had been reduced by $575,000 since January 1, 1932, thereby reducing borrowed moneys to a new low since 1924 (48). In June, 1932, Martin L. Straus and Elias Mayer were appointed equity receivers for Hartman by the U. S. District Court for the Northern District of Illinois, Eastern Division. The receivers entered into possession of the property of Hartman and continued its business of buying and selling furniture and other household articles from the time of their appointment until May 26, 1933 (20, 38).

The bill of complaint requesting the appointment of equity receivers for Hartman alleged that the *corporation's assets were greater than its liabilities,* but that it was temporarily unable to meet its current obligations, and that by reason thereof, it prayed for the protection

of a court of equity and the appointment of equity receivers to take possession of its property and assets, and to continue its business (33). In the bill of complaint in said action, it was further alleged "that said assets upon thus being administered in a court of equity, through said receivership, will be sufficient to pay *in full* all liabilities against said defendant, and that *a surplus will be left for the benefit of defendant's stockholders*" (33). These allegations of the bill of complaint were admitted to be true by Hartman (38).

A suit against the directors of Hartman, hereinafter called the Graham suit, was instituted on December 16, 1932 in the Supreme Court of the State of New York. The petitioner and eight other stockholders of Hartman were plaintiffs. The defendants were the corporation, Hartman, and nine directors. The plaintiffs brought the suit "on behalf of themselves as stockholders of the Hartman Corporation and on behalf of the said Company and all other stockholders of said Company similarly situated, who may join with the plaintiffs in, and contribute to the expenses of, this suit" (55). The complaint charged the defendants with waste and mismanagement and demanded that the defendants render an accounting and pay into the treasury of the corporation the amount of the loss and damage sustained by it by reason of their wrongful acts (61). More specifically, the complaint alleged that during the years 1929 and 1930 the directors and officers of Hartman caused it to purchase in the open market, for cash, 64,789 shares of its Class B, or junior, stock at an average cost of $22 per share and an aggregate cost of approximately $1,422,000 (58). The complaint alleged that part of this Class "B" stock was purchased by the corporation from the individual directors and officers (59). It was also alleged that the directors, without the knowledge of the stockholders, caused the corporation thereafter to sell the Class "B"

stock to its employees (including its officers and directors), at a price of $16 per share, $6 per share less than the cost of the stock to Hartman, with an agreement by the corporation to repurchase the stock, *at the option of the purchasers,* at the cost to them of $16 per share. The corporation repurchased large amounts of the stock at the price of $16 per share (59-60). Thereafter, the stock became worthless. The entire amount of $1,422,000 expended for the stock was lost (58-60).

It is interesting to compare the corporation's loss on the 64,879 shares of stock purchased by it, aggregating $1,422,000, with the total liabilities of the corporation amounting to $630,574 (23) at the termination of the equity receivership. The recovery on this single element of wrongdoing, exclusive of all other acts of mismanagement, would have been more than twice the total of all the liabilities of the corporation. A substantial equity therefore remained for the stockholders in the cause of action against the directors.

In 1933 a new corporation called Hartman's, Inc. was organized under the laws of the State of Delaware (20). As of May 26, 1933 Hartman's, Inc. purchased at a bankruptcy sale the assets of Hartman Furniture and Carpet Company, a wholly owned subsidiary of Hartman, for the sum of $501,000 in cash and an agreement to procure a waiver of certain inter-company claims against the bankrupt estate. The stock of the new company was issued to the creditors of Hartman Furniture and Carpet Company in settlement of claims, and to the stockholders of Hartman by subscription thereto. The stockholders of Hartman were given the right to subscribe for debentures and stock of Hartman's Inc. in 1933. Petitioner did not exercise her right of subscription (21).

On August 10, 1934, the receivers of Hartman filed a report with the court listing as assets $39,593.13 in cash

and *a suit pending against the directors* (the Graham suit), and as liabilities total outstanding claims amounting to $707,430.67. The receivers recommended that claims totalling $630,574.57 be allowed. The Court approved this report (21). The receivers filed a second report on July 11, 1935, listing as assets $27,192.51 in cash *and the Graham suit pending against the directors,* and as liabilities the aforesaid claims. The receivers recommended that a dividend of 4 per cent be paid on the claims of $630,574.57 allowed, which was paid (21).

The Graham suit was vigorously prosecuted. During the years 1933 to 1936, inclusive, examinations before trial of certain of the directors were held from time to time in New York City. Petitioner's counsel also went to Chicago, Illinois, during this period and spent four days there on the examination before trial of certain of the defendants who resided in that City (22). In the course of such examinations before trial, many hundreds of pages of testimony were taken and numerous exhibits were offered in evidence (22). Petitioner and the other plaintiff stockholders were ordered by the New York Supreme Court to pay the counsel fees, transportation and hotel expenses of the *defendants'* New York counsel who traveled to Chicago and represented said defendants on such examinations (22). Such counsel fees and expenses of defendants' counsel amounted to approximately $800 (22). Petitioner and the other plaintiff stockholders also paid the transportation and hotel expenses of their own counsel in attending upon such examinations, as well as the fees of the stenographer who reported the testimony, and also paid the fees of the commissioner before whom the examinations were held (22). Petitioner and other plaintiff stockholders also paid for the cost of printing briefs in the Appellate Division of the New York Supreme Court on an appeal which defendants had taken to such Court (22-23). The amount of disbursements paid by

petitioner and the other plaintiff stockholders, exclusive of the fees of their own counsel, amounted to approximately $2,800 (77).

At the conclusion of the examinations and shortly before the trial, negotiations were commenced for a settlemen of the action, and on February 20, 1937 such settlement was consummated (23). Under its terms the defendant directors paid the petitioner and the other plaintiff stockholders the sum of $50,000 in full settlement and discharge of the claims of the petitioner and of her co-plaintiffs.* In connection with the settlement the petitioner and the other stockholders released all their rights and claims arising out of the acts committed by the defendants as alleged in the complaint. The suit was thereafter dismissed on May 14, 1937 (23).

After the settlement of the Graham suit the receiver filed a final report with the court on September 30, 1937, and he was thereafter discharged by an order dated September 30, 1937 (21-22).

Petitioner's proportionate share of the $50,000, after payment of counsel fees and expenses, amounted to $12,500. In her income tax return for 1937 she claimed a deduction from gross income in the amount of $19,940, being the difference between $32,440, the cost of the stock, and $12,500, the amount of her recovery, as a loss due to the worthlessness of her Hartman stock. The Commissioner denied the deduction and included as ordinary income in that year the sum of $12,500, which she had received pursuant to the settlement (23). The Tax Court affirmed his determination. The Circuit Court of Appeals

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* Under the law of New York, in which State the action was brought, petitioner and those who joined with her had the right to effect settlement of their individual claims to damages. *Manufacturers Mutual Fire Ins. Co.* v. *Hopson*, 176 Misc. 220, aff'd 262 App. Div. 731, aff'd 288 N. Y. 668.

reversed in part, and held that the $12,500 constituted a capital item in reduction of petitioner's loss and was, therefore, not taxable as income. However, it held that the balance of $19,940, representing the unrecovered cost, was a loss which could not be deducted in 1937, on the ground that the Hartman stock had become worthless prior thereto (80).

The pertinent statute and regulations involved are printed in the appendix attached.

Specifications of Errors

Petitioner urges that the Circuit Court of Appeals erred in holding

(1) that the objective test was solely to be used in determining the year in which the stock became worthless, and that the taxpayer's honest belief, as shown by her conduct in vigorously prosecuting the Graham suit to a successful conclusion, was not to be considered;

(2) that the decision of the Tax Court, when based on an agreed statement of facts, constitutes a determination of fact and not of law.

(3) that under the objective test the stock became worthless prior to 1937.

Summary of Argument

I. The Court below erred in holding that the taxpayer's reasonable and honest belief, the correctness of which was confirmed by events, that her stock was not valueless until the action brought by her had been settled and her rights released, was not to be considered in determining when the loss was deductible.

II. The decision of the Tax Court on an agreed statement of facts constitutes a determination of law.

III. Even viewed objectively, petitioner's stock in Hartman Corporation did not become worthless until the petitioner's action was settled and her claim released.

POINT I

The Court below erred in holding that the taxpayer's reasonable and honest belief, the correctness of which was confirmed by events, that her stock was not valueless until the action brought by her had been settled and her rights released, was not to be considered in determining when the loss was deductible.

The cause of action against the directors was an asset owned by the Corporation. It constituted property, just as much as a building or machinery or any other form of tangible property. Until the cause of action was terminated, insofar as petitioner's interest therein was concerned, it could not be determined that taxpayer's stock was worthless, or even whether there would be a loss thereon, or what that loss would be. Whether there would be a loss, and the amount of the loss, was ascertained for the first time when the settlement was reached

in 1937. That taxpayer honestly believed that her stock had not become valueless and that the cause of action which she and the other stockholders were prosecuting had merit, is demonstrated by the conceded facts.

It was stipulated in the Tax Court that extensive services were rendered in the prosecution of the Graham suit over a period of four years from 1932 to 1937 (22-23).

The action was commenced in 1932 by petitioner and eight other stockholders to recover for the waste and mismanagement of Hartman. On one count alone, namely, the purchase by Hartman of its junior shares at a cost of $1,422,000 (stock which subsequently became completely worthless), the recovery would have been about $800,000 in excess of creditors' claims. Other causes of action were set forth in the complaint, such as payment of extravagant salaries, making of improvident contracts, etc. (58). The stipulation concedes that the suit was vigorously prosecuted. Petitioner's counsel spent four days in Chicago in examining certain defendants who resided in that city (22). Certain of the defendants were examined in New York (22). Many hundreds of pages of testimony were taken and numerous exhibits offered (22). Petitioner and the other complaining stockholders were required to, and did, pay the fees of various New York counsel for defendants in attending the examinations in Chicago, as well as their traveling and hotel expenses, and those of their own counsel (22). They paid the fees of the Commissioner before whom the depositions were taken, as well as those of the stenographer who took them (22). They paid for the printing of briefs on appeal to the Appellate Division of the New York Supreme Court. Petitioner and her co-plaintiffs paid disbursements of approximately $2800, exclusive of fees of their own counsel, in the prosecution of the action (77). Peti-

tioner's good faith and confidence in the litigation which she had brought against the directors was therefore attested by its vigorous prosecution over a period of years, as well as by the payment of substantial disbursements in the prosecution of the action, and her willingness to incur substantial counsel fees for her own counsel in connection with extensive services rendered. Under those circumstances, we respectfully submit that petitioner should have been permitted to deduct her loss on the stock in the year in which she believed, and had a right to believe, it had become worthless, and in which in fact it ceased to have further value owing to her settlement of the case and the release of her cause of action.

In *Smith* v. *Helvering*, 141 F. (2d) 529, which the Court below refused to follow, the Court of Appeals for the District of Columbia held that the taxpayer's opinion and belief, as evidenced by his acts, are decisive of the year in which a worthless stock loss should be taken. In that case the Commissioner determined a deficiency against the taxpayer for the calendar year 1937. The taxpayer deducted a loss on certain stock of San-i-Sal Laboratories, Inc., in that year. It was shown that the corporation's business was suspended early in 1929 and that thereafter it had no full time employees and filed no Federal income tax return. It was shown that from 1925 to 1937 the petitioner advanced funds on behalf of the corporation. In 1937 a Certificate of Dissolution was filed with the Secretary of State of Delaware. *It was not disputed that the corporation was insolvent prior to 1937.* The Board of Tax Appeals stated that "the loss must be taken in the year in which it was sustained and at no other time" and this means the year in which these shares in every substantial and realistic way became worthless. In reversing the Board of Tax Appeals, the Court, per Justice Miller, stated at page 530:

"We think the decision of the Board too severely restricted the taxpayer and sets too high a standard of industrial performance; especially in light of the remarkable industrial developments often achieved by courageous and optimistic American businessmen, who refused to be dissuaded when bankers and other conservative citizens advised that their enterprises were worthless in 'every substantial and realistic way.' Henry Ford is a striking example. Even though, perhaps, a businessman should not be encouraged to be an incurable optimist, if he is one, nevertheless, and continues to express his optimism by putting money into an insolvent organization, he should be given the benefit of the doubt. This would seem to be particularly true where, as here, the suspension of business occurred in 1929, the year of the great panic, and the transfusions administered by the taxpayer occurred during the period of the most severe depression ever experienced in this country.

"The case which comes closest in its facts to the present case is *Rassieur* v. *Commissioner* [129 F. 2d 820]. The nub of the decision appears in the following language: 'So long as taxpayer was willing to protect or pay the company debts and to advance funds for its current expenses, no one could say that any "identifiable events" had occurred which finally determined the worthlessness of the stock.' The language of that opinion which immediately precedes the statement quoted is remarkably apt: 'The panic struck this, as all other business, like a blight. Its business decreased and its owned securities diminished drastically in market value while expenses and indebtedness continued. In the endeavor to weather the storm and continue the business, various steps were taken, such as progressive restriction of business, curtailment of expenses, and sale of the "market service." It is evident that there was no time from 1931 to dissolution when it could have converted its assets, paid its debts and had anything remaining for stock value if it had been compelled to rely only upon its own resources and to liquidate. From the latter part of 1931, it could not have continued in business or paid

its debts when due if it had been compelled to rely solely upon its own resources. However, the actual fact was that it did not have to so rely on its own resources alone. While there was neither legal nor moral obligation so to do, yet there were strong reasons of self-interest and probably of sentiment (help to his son) which impeled Theodore Rassieur to come to the financial aid of the company and he did so. The sole purpose of these two reasons was the same—to preserve the business. Unless that could be done, the taxpayer stood to lose at least the $250,000 he had contributed (for himself and the two others) to the capital stock; and his son would be out of business. The mere winding up of this business would have defeated the purpose entirely. There can be no question that this purpose to preserve the business was the dominant moving consideration of these three men, who held all of the capital stock, during this entire period. The accomplishment of the purpose depended entirely upon the willingness of taxpayer to make advances. As long as he continued willing, the business would last. As long as it lasted, there was a prospect of its successful survival.' "

The Court then specifically held that the test that should be applied in determining the year in which the stock became worthless was a *subjective* and not an *objective* standard. The Court said, at p. 531:

"The test proposed by the Board in the present case is a highly objective one which disregards what the taxpayer may think of his investment, how much of an optimist he may be, or what he may consider to be the possibilities of future successful operation, or of eventual recoupment. An examination of the cases persuades us that the subjective appraisal of the taxpayer is of much greater importance. The Supreme Court said as much in *United States* v. *S. S. White Dental Manufacturing Company* [274 U. S. 398]. In *Forbes* v. *Commissioner*, Judge Parker, speaking for the Court of Appeals of the Fourth Circuit and reversing a decision of the Board in a similar case

used the following language: 'Practical considerations must govern, for it is as true here as in Lucas v. American Code Co., 280 U. S. 445, 449, * * * that: "No definite legal test is provided by the statute for the determination of the year in which the loss is to be deducted. The general requirement that losses be deducted in the year in which they are sustained calls for a practical, not a legal test." * * * As said by Judge Learned Hand in de Loss v. Commissioner (C. C. A. (2d) 28 F. (2d) 803, 804), "So far as *human foresight* could go, the shares were worthless, and the petitioner might have deducted the loss." We are not dealing with a case where *there was hope* that a business although involved *might be saved* and value in the stock established. *Hope* had been abandoned and *liquidation had been ordered.*' (Italics supplied.) In *Lucas* v. *American Code Company,* the Supreme Court pointed out that the test which should be applied is a practical and not a legal one. In that case the loss which was paid by the taxpayer in 1923 resulted from a breach of contract which occurred in 1919. The Court upheld a determination of the Board that the deduction could not be taken in 1919 because of the various possibilities which then existed affecting the amount of the recovery which might be, eventually, obtained against the company. Among other things the Court listed, as evidencing the attitude of the taxpayer, that it did not accrue on its books during the tax year of 1919 any liability in the estimated amount of the loss; and that reserves set up by the taxpayer during that year bore no relation to the apprehended loss. The Court concluded by saying: 'It cannot be said that the loss actually paid by the Company in 1923 was, as a matter of law or of undeniable fact, sustained in 1919. *Nor did the Company so regard it.*' (Italics supplied.) If the taxpayer's attitude is a proper subject of appraisal in one case it should be in another. Similarly, in *Benjamin* v. *Commissioner* [70 F. 2d 719], a subjective test was applied. It was held that the mere shutting down of a mill and suspension of business—other than prospecting for additional soapstone deposits—was not sufficient to show a complete loss;

and this in spite of the fact that no deposits were actually uncovered. The court held that while *hope* and *possibility of success* remained, proof of loss was not complete. In the present case, if we reason from the taxpeyer's attitude, hope had not been abandoned and possibility of success remained."

In the instant case, the petitioner did not believe that her stock was worthless prior to 1937. No other inference can be drawn from the conceded facts. Petitioner and the other stockholders who were plaintiffs in the Graham suit employed counsel and advanced substantial sums of money in prosecuting what they considered a meritorious cause of action on behalf of the corporation. Expenditures, exclusive of counsel fees, amounted to approximately $2,800. Would the petitioner and the other plaintiff stockholders have spent at least $2,800 for disbursements, in addition to counsel fees, for the very extensive services which were being rendered in prosecuting this cause of action, had they considered the stock worthless? So long as the petitioner asserted her rights as a stockholder, and spent substantial sums of money in asserting them, we do not believe it can reasonably be inferred that she believed her stock to be worthless.

We do not contend that the *subjective* test should be based merely upon the unsupported opinion or belief of the taxpayer. However, where there is a reasonable basis for the taxpayer's belief that his stock has not become worthless, and the honesty of that opinion is evidenced by affirmative conduct on the part of the taxpayer which is irreconcilable with a contrary conclusion, then we respectfully submit that the *subjective* test as to when the stock has become worthless is the proper test to be applied. This is particularly true when, as in the instant case, *the taxpayer's opinion was by the actual course of events demonstrated to be correct.* The recovery by the taxpayer, and the other plaintiffs in the Graham suit, of the sum of

$50,000 in 1937 demonstrates the correctness of the taxpayer's opinion that her stock had not become worthless prior to that year.

A case directly in point is the case of *Louisville Trust Company* v. *Glenn*, 33 F. Supp. 403 (aff'd 124 F. 2nd 418, C. C. A. 6th). In that case an agent made an unauthorized investment in stock which became worthless in 1930, and principal's committee, appointed in January, 1931, promptly repudiated the investment and demanded return of the money so invested and employed attorneys to enforce the claim against agent. The Court held that the loss resulting from the unauthorized investment and the committee's recoupment therefor were merely separate phases of a single continuous transaction which was not completed until the net loss was determined by acceptance of the compromise payment in 1933, and therefore the net loss was a proper deduction in determining principal's taxable income for 1933. The Court in its opinion adverted to the fact that in the cases in which the courts had held that the loss must be taken in an earlier year, "the taxpayer had no reasonable hope at the time of the loss of any eventual recoupment" (p. 408). In its very interesting opinion, the Court among other things, said:

> "The defendant's theory of treating the loss which occurred in 1930 as an entirely separate and distinct transaction from the recovery later obtained from the Trust Company has some support from the decisions of the Supreme Court in United States v. S. S. White Dental Mfg. Co., 274 U. S. 398, and Burnet, Commissioner v. Sanford & Brooks Co., 282 U. S. 359. Those cases held that the fact that a taxpayer recovers a small part of a loss in a subsequent year does not invalidate the loss for the year taken when its deduction was based on the exercise of reasonable judgment from facts then known; and that such later recovery becomes a part of the gross income of the year of its receipt. See, also, Rhodes v.

Commissioner, 6 Cir., 100 F. 2d 966. But that rule is based upon the fact that the *taxpayer had no reasonable hope at the time of the loss of any eventual recoupment. Where the facts giving rise to the loss are at the same time the basis for a substantial recoupment,* and reasonably recognized as such, it is only common sense to treat the loss taken as the difference between the value of the property lost or destroyed and the amount recovered. As a practical matter no loss is 'taken' until the amount of the recovery has been determined, provided the initial loss and the recovery are parts of the same transaction. It was held in Dresser v. United States, supra (55 F. 2nd 499), that a loss resulting to a taxpayer through ownership of stock in a corporation being liquidated was not deductible in the year 1919 where it appeared that a subsequent and final liquidating dividend uncertain in amount was reasonably anticipated even though delayed for several years. In that case the liquidation was substantially completed by December 31, 1919, and an estimate made of the final credit to be later received, which was not actually received until May, 1924. It was held that the net loss was a deductible item for the year 1924, and not for 1919 as claimed. If a loss results from the destruction of property which is accompanied by salvage, the net loss is not ascertained until the value of the salvage has been determined. Deductible losses must be evidenced by closed and completed tranactions, fixed by identifiable events. Lucas, Commissioner v. American Code Company, 280 U. S. 445; Central Trust Co. v. Burnet, Commissioner, 60 App. D. C. 4, 45 F. 2d 922; Ewing Thomas Converting Co. v. McCaughn, Collector, 3 Cir., 43 F. 2d 503. In the present case it is a disregard of the admitted facts to say that Pirtle's Committee in 1931 considered the Banco Kentucky Company investment a total loss, *or that it had no reasonable hope of a substantial recoupment* from the Trust Company. It promptly repudiated the investment and demanded the return of the money so invested. It employed attorneys to enforce the claim. It refused to compromise its claim at any time for less than 76 cents on the dollar. The claim was

never abandoned and the matter was never a closed or completed one until the settlement was reached in 1933. As was said in Rhodes v. Commissioner (6th Circuit), supra (100 F. 2d 969), 'Common sense interpretation is the safest rule to follow in the administration of income tax laws.' The common-sense interpretation of the present case is that the loss resulting from the unauthorized investment and the committee's recoupment therefor were merely separate phases of a single continuous transaction and that the matter was not a closed or completed transaction until the net loss was determined by the acceptance of the compromise payment in 1933."

The facts in the instant case are almost identical with those in the *Glenn* case, *supra*. In the present case the petitioner and her co-plaintiffs promptly asserted their rights by commencing an action within a few months after the appointment of the equity receivers of Hartman Corporation. Paraphrasing the language of the Court in the *Glenn* case, "it is a disregard of the admitted facts to say that petitioner and her co-plaintiffs considered their investment in Hartman Corporation a total loss or that they had no reasonable hope of a substantial recoupment in the suit against the directors. Petitioner and her co-plaintiffs employed attorneys to enforce their claim. In addition, they spent substantial sums of money in prosecuting their action. They refused to compromise the claim for less than a substantial amount. The claim was never abandoned and for that matter was never a closed or completed one until the settlement was reached in 1937."

The Board of Tax Appeals has repeatedly applied the subjective test in determining when stock has become worthless. In *Sterling Morton* v. *Commissioner*, 38 B. T. A. 1270, the Board said that "stock may not be considered worthless even when having no liquidating value if there is a reasonable *hope* and *expectation* that it will become valuable at some future time." The hope and expecta-

tion to which the Board of Tax Appeals referred necessarily meant the hope and expectation of the taxpayer. So long as the taxpayer had hope and expectation of ultimate recovery, provided that such hope and expectation was not chimerical and without basis, the stock still had potential value and had not become worthless. This is the application of the subjective test.

In the *Sterling Morton* case, *supra*, the Board of Tax Appeals said at page 1278:

> "• • • a loss by reason of the worthlessness of stock must be deducted in the year in which the stock becomes worthless and the loss is sustained, that stock may not be considered worthless even when having no liquidating value *if there is a reasonable hope and expectation that it will become valuable at some future time*, and that such hope and expectation may be foreclosed by the happening of certain events such as the bankruptcy, cessation from doing business or liquidation of the corporation, or the appointment of a receiver for it. Such events are called 'identifiable' in that they are likely to be immediately known by everyone having an interest by way of stockholdings or otherwise in the affairs of the corporation, but, regardless of the adjective used to describe them, they are important for tax purposes because they limit or destroy the potential value of stock • • •. If the assets of the corporation exceed its liabilities, the stock has a liquidating value. *If its assets are less than its liabilities but there is a reasonable hope and expectation that the assets will exceed the liabilities of the corporation in the future, its stock, while having no liquidating value, has a potential value and cannot be said to be worthless.* The loss of potential value, if it exists, can be established ordinarily with satisfaction only by some 'identifiable event' in the corporation's life which puts an end to such hope and expectation."

In *re William E. Templeman*, 20 B. T. A. 493, the Board of Tax Appeals also applied the subjective test as to when

stock became worthless. In that case it based its decision that the loss did not occur in the year claimed by the Commissioner on the fact that "the petitioner was expending time and money in an effort to save the corporation, and he must have had *hopes* of realizing something from his investment." The petitioner had bought large amounts of stock in an oil company in which he was heavily interested. A dispute arose in the latter part of 1920 and early 1921 as to the control of the company. The opposing group procured the filing of an involuntary petition in bankruptcy. Late in 1921, petitioner had this petition vacated on the ground that the proceeding was collusive. Petitioner then had a receiver appointed, and the opposing interest in the corporation and the receiver proceeded to operate the business of the corporation. Numerous other suits were filed by or against petitioner, the receiver and the corporation. In 1922 no funds were available in the hands of the receiver, and petitioner and the opposing group were without money to continue the litigation. At that time the corporation owed debts of $85,000, which it could not pay. Petitioner took the loss as a worthless security in 1922. The commissioner claimed it should have been taken in 1921, when the Corporation was put into bankruptcy. The Board of Tax Appeals held that the loss was sustained in 1922, saying at page 495:

> "The respondent has determined that the stock became worthless in 1921, apparently upon the ground that the company was declared a bankrupt in that year. The evidence is clear, however, that the adjudication in bankruptcy was irregular, and that it was vacated.
>
> "*Throughout 1921 the petitioner was expending time and money in an effort to save the corporation, and he must have had hopes of realizing something from his investment.* In 1922 it was clear that his stock was worthless, and he so determined when he deducted the amount on his income tax return for that year. The respondent erred in disallowing the deduction claimed."

In the instant case petitioner and other stockholders of Hartman not only expended time and money in the hope of ultimately recovering, but *actually succeeded in recovering a substantial part of the cost of their stock.*

In *William H. Redfield,* 34 B. T. A. 967, 971, *supra,* the question was whether stock in Caro Process Corporation should be determined as worthless in 1932, as petitioners claimed, or in 1931. The Caro Cloth Corporation had a contract with the Caro Process Co. whereby Caro Cloth Corporation licensed the use of certain machinery. A controversy arose between the two companies as to the quality of the machinery; as a result Caro Process Corporation sued Caro Cloth Co. in 1930 to recover payments made on the machine. This suit was dismissed for lack of prosecution in 1931. On dismissal of this suit in 1931 one of the petitioners, a stockholder of Caro Process, started negotiations with the President of the Caro Cloth Co. in behalf of Caro Process to recover something for Caro Process Corporation. In the fall of 1932, the last settlement conference was held, and petitioner Biggs was informed that there was no chance of settlement because of the bad financial conditions of Caro Cloth Co. It was held that the loss was deductible in 1932 "as petitioners believed in good faith that something would be recovered." The Board of Tax Appeals said at p. 971, *supra*:

> "The respondent contends that the identifiable event which fixed the date of the losses in controversy here occurred in 1931, when the suit instituted by the Process Corporation against the Caro Cloth Co. was dismissed for lack of prosecution. Petitioners argue that the losses could not be said to have been sustained at that time for the reason that thereafter there was reasonable expectation of effecting recovery of a substantial amount of their investments through friendly negotiations with the President of the Caro Cloth Co. These negotiations were concluded late in 1932, at which time all hope of recovery was abandoned.
>
> "From a careful consideration of the evidence, we are of the opinion that the contention of the peti-

tioners on this point must be sustained. At the end of 1931 it could not be said that the losses of these petitioners were complete. The circumstances as they existed at that time undoubtedly indicated a strong probability that there would be some loss, but negotiations were being actively carried on with a view to the recovery in one form or another of at least a portion of the petitioners' investments. *Apparently petitioners believed in good faith that something would be recovered,* and the situation, we think, reasonably supported such belief. Except for the financial difficulties encountered by the Caro Cloth Co. in 1932, the negotiations conducted by Biggs would have probably resulted in saving a substantial amount of the petitioners' investments. When those negotiations definitely failed during the taxable year solely because of the bad financial condition of the Cloth Company, the stock of the Process Corporation became worthless, and this event fixed the date of the petitioners' losses."

In the instant case, petitioner's action was vigorously prosecuted from 1933 to 1937. Petitioner in good faith believed that something would be recovered on her stock. The settlement negotiations were actually fruitful, resulting in the petitioner recovering $12,500, after the payment of counsel fees and expenses.

The difference between the application of the so-called subjective as distinguished from the objective test as to when stock becomes worthless appears to rest mainly in the fact that in the application of the subjective test the reasonable belief, expectation and conduct of the taxpayer are taken into account, whereas in the application of the so-called objective test the transaction is viewed not as it would appear to a reasonable person at the time, but only in the light of subsequent events. We respectfully submit that what the taxpayer honestly thought at the time concerning the value of his investment, particularly when he acted upon that belief and expended money and effort in attempting to salvage his investment, is the test which

should be applied in determining when his stock has become worthless. The so-called objective test, in essence, is the test of hindsight. It disregards what a prudent person would have thought and done at the time, and views the transaction solely in the cold light of subsequent events. It is an old axiom that hindsight is better than foresight. It would, however, be grossly unfair to a taxpayer, struggling to salvage a loss, to hold that his honest and reasonable belief of reducing his loss would be of no avail to him taxwise if by hindsight it could be said that his efforts might not be successful.

In the instant case, however, *the taxpayer's belief that her stock had not become worthless was by the actual course of events demonstrated to be correct.* So that even by the application of the objective test, namely, the *test of hindsight,* the taxpayer's stock had not become worthless prior to 1937, when she obtained her recovery and released her rights.

It is true that petitioner attempted to deduct her loss on the Hartman stock in the year 1934. From this circumstance the court below inferred that petitioner then thought her stock to be worthless (78). However, the court below itself recognized the dilemma in which taxpayers often find themselves as to when the loss should be taken on a worthless security, and in *Young* v. *Commissioner,* 123 F. (2d) 597, 600, said:

> "In cases like this the taxpayer is at times in a very difficult position in determining in what year to claim a loss. The only safe practice, we think, is to claim a loss for the earliest year when it may *possibly* be allowed and to renew the claim in subsequent years if there is any reasonable chance of its being applicable to the income for those years."

Petitioner did no more than to adopt "the only safe practice", suggested by the court below. Furthermore, the inference which the court below drew is contradicted

by the conceded fact that after 1934 petitioner for three years continued vigorously to prosecute her lawsuit and to expend substantial sums of money thereon. This is irreconcilable with the inference that petitioner had abandoned all expectation of recovery.

The court below also stated that the fact that other stockholders did not intervene in the Graham suit was not without significance. The court below, however, was unaware of the circumstances (a) that other stockholders did seek to intervene, but that their application was denied; and (b) that other stockholders did actually commence their own action in the New York Supreme Court against the Hartman directors, which action was also settled at about the same time that the Graham suit was settled. While it is true that these facts do not appear in the record, yet it is also true that the contrary does not appear. There is no support in the record therefore for the mistaken assumption by the court below that other stockholders had not sought to assert their rights (78).

Likewise, the court below was influenced by its assumption that the equity receivers were not interested in prosecuting the cause of action (78). The court below, however, overlooked the fact that that lack of interest was due not to lack of merit in the cause of action but to the adverse interest of the equity receivers. The equity receivers were Martin L. Straus and Elias Mayer (20). Martin L. Straus was the President, a director, and the moving spirit of the Hartman Corporation, and a principal defendant in the Graham suit (88). He could not, therefore, be expected to prosecute the Corporation's suit against himself. Elias Mayer was Straus's lawyer and it would be unreasonable to expect that he would prosecute a cause of action against his own client. In fact, Mayer was a defendant in the other stockholders' action instituted in the New York Supreme Court, which

was likewise settled (88). As was stated by the court in *Norman* v. *Federal Mining & Smelting Co.*, 180 App. Div. 325, at page 335:

> "It is not to be assumed that they (the directors) would prosecute in good faith an action based on their own misconduct."

Hence, the fact that the equity receivers did not prosecute the corporation's cause of action against the directors is wholly without significance in appraising the value of the Graham suit.

POINT II

The decision of the Tax Court on an agreed statement of facts constitutes a determination of law.

The Court below construed the decision of the Tax Court that petitioner's stock did not become worthless in 1937 as a determination of fact that it could reverse only if unsupported by substantial evidence (77). We do not question the general rule, but we respectfully submit that it has no application where the facts are conceded.

The within case was submitted to the Tax Court on an agreed statement of facts. Where the facts are conceded, the decision of the Tax Court constitutes a determination of law and not of fact. Where a case is submitted on agreed facts, the Court to which it is submitted makes no findings of fact. In such case the Court is required to determine only the legal consequences arising from the undisputed facts. Such a decision constitutes a conclusion of law and not of fact.

The Court below therefore was mistaken in assuming that it could not review the determination of the Tax Court because it was a determination of fact. The decision of the Tax Court constituted a determination of law

which was reviewable in the Court below, as well as in this Court.

In *G. E. Employees Securities Corporation* v. *Manning*, 137 F. 2d 637, (C. C. A., 3rd), an action to recover monies paid on a deficiency assessed by the Commissioner, was tried without a jury and on a stipulation of facts. The Court said at page 639:

> "Since the facts are not in dispute, and indeed were stipulated, the conclusions drawn from these facts are subject to appellate review" (citing cases). "The issue before us is whether the District Court's conclusion from the stipulated facts, that the Company's stock was worthless prior to 1936 is correct."

In *Exmoor Country Club* v. *United States*, 119 F. 2nd 961 (C. C. A. 7th), the Court at pages 841 and 842, said:

> "In this case the facts are not in dispute. The problem is one of construction, i. e., the application of the Taxing Statute. In such situations where the ultimate finding is a conclusion of law or at least a determination of a mixed question of law and fact, it is subject to judicial review, and on such review the appellate court may substitute its judgment for that of the trial court. Bogardus v. Commisioner, 302 U. S. 34, 39, and Deputy et al. v. Du Pont, 308 U. S. 488, 499."

In *Feist v. Fifth Avenue Bank*, 280 N. Y. 189, the New York Court of Appeals at page 190, said:

> "This case having been submitted on agreed facts pursuant to Section 546-548 of Civil Practice Act, the Appellate Division was without power to draw inferences of fact. The question presented is whether the judgment correctly defines the effect of the stated facts as a matter of law, not whether there is any evidence upon which supported findings could have been made." Lafrinz v. Whitney, 233 N. Y. 107; Title Guarantee & Trust Co. v. Mortgage Commission, 271 N. Y. 302.

POINT III

Even viewed objectively, petitioner's stock in Hartman Corporation did not become worthless until the petitioner's action was settled and her claim released.

According to the conceded facts, a cause of action accrued to Hartman Corporation against its officers and directors for the damage it had sustained arising from the purchase of its junior stock (some of which was purchased from the officers and directors themselves), as a result of which the corporation lost $1,422,000, the entire amount expended for the stock (58). In addition other causes of action were alleged for payment of extravagant salaries, wasteful management, *etc.* These causes of action constituted a valuable asset of the corporation. If successfully prosecuted, they would net an amount far in excess of the claims of creditors. The causes of action were vigorously prosecuted over a period of more than four years. Extensive services were rendered and substantial sums of money expended in their prosecution. The good faith of petitioner and her co-plaintiffs in prosecuting that action has not been, and cannot be, questioned. The action was not compromised for a sum which represented merely nuisance value. It resulted in a substantial recovery. After payment of counsel fees and expenses, petitioner recovered approximately 40% of the cost price of her stock. Even viewed objectively, how can it be said that this stock had become worthless before the settlement was made?

The cases are quite uniform in holding that whenever a transaction gives rise to litigation neither party to the transaction realizes income or sustains a loss from that transaction until the litigation is finally settled or determined.

Morton v. *Commissioner*, 104 F. (2d) 534;
Re Russel Wheel & Foundry Co., 3 B. T. A. 1168;

William E. Templeman, 20 B. T. A. 493;
William H. Redfield, 34 B. T. A. 967;
Re George C. Peterson Co., 1 B. T. A. 690;
Cooley Butler v. *Commissioner*, 45 B. T. A. 593;
Sterling Morton v. *Commissioner*, 38 B. T. A. 1270;
Sabath v. *Commissioner of Internal Revenue*, 100 F. (2d) 569.

In *Morton* v. *Commissioner*, 104 F. (2d) 534, *supra*, the taxpayer deducted a loss sustained on the foreclosure of a deed of trust on certain property in 1934. The taxpayer and another had jointly purchased the property in 1912 for $45,000. In 1923, they jointly borrowed $25,000 from the North Carolina Joint Stock Land Bank and gave the latter, as security, a deed of trust on the property. In 1931 at the Bank's request, the trustee named in the deed of trust advertised the property for sale at public auction, and it was sold on January 9, 1932, being bought in by the trustee. Later two actions were commenced. The taxpayer sued to enjoin the trustee from executing a deed to the purchaser, claiming that the sale was null and void, and the Bank sued the taxpayer to recover a deficiency of $11,143.38. In the taxpayer's answer in the latter action, he set up as a defense the same facts which formed the basis of his injunction action. Before the suits were reached for trial, they were settled by taxpayer paying to the Bank $2,500. Taxpayer took the loss in the year of the settlement. The Commissioner held that the loss occurred in 1932 at the time of the foreclosure sale. The Board of Tax Appeals upheld the Commissioner and disallowed the loss. The Circuit Court of Appeals, 4th Circuit, reversed, saying (p. 536):

> "• • • The final settlement of this litigation was the determinative event which fixed the time of the loss. • • •
>
> "It has been held in numerous cases that whenever a transaction between two parties gives rise to claims

and counterclaims, and litigation ensues involving the rights and claims of both, neither party sustains a loss or realizes income from that transaction until the litigation is finally determined, or settled by agreement of the parties. Consolidated Tea Company v. Bowens, D. C., 19 F. 2d 382; Ewing Thomas Converting Company v. McCaughan, 3 Cir., 43 F. 2d 503. • • •

"As long as the two law suits were pending the taxpayer's legal rights in the land or its value were unsettled and unknown and the ultimate loss, if any, was contingent and could not be deducted. The Commissioner would have rightly refused a deduction before the loss was definitely ascertained. • • •

"The effect of the litigation was to postpone the fixing of the loss until the year in which the settlement was made."

The Court below attempted to distinguish the *Morton* case, *supra*, on the ground that the Court in that case held that "the validity of the sale was not determined until the litigation ended." We fail to see the distinction. In the present case the amount of the Hartman Corporation's assets, and the value of its cause of action against the directors, was not determined, so far as the petitioner was concerned, until the case was settled and the litigation ended.

In *Re Russel Wheel & Foundry Co.*, 3 B. T. A. 1168, *supra*, the taxpayer had entered into a contract with another corporation to supply it with certain fabricated steel for the erection of a theater. During construction, the building plans were changed and taxpayer claimed it was entitled to the value of the steel it had fabricated, but which the other corporation had not used due to the change in plans. The latter sued taxpayer for damages for delay and taxpayer sued for what it claimed to be the balance due it on its account. Both suits were finally settled by the payment to the taxpayer of $4,250 out of a claimed balance due it of $13,438.62. The Commissioner disallowed the deduction of $9,938.62 (the loss after de-

ducting the settlement figure less $750 counsel fees), and the Board of Tax Appeals reversed, saying (p. 1170):

> "We are satisfied from the evidence that the claim asserted by the taxpayer was bona fide and that the compromise was the result of the suit for damages for failure to perform. It is our opinion that, in these circumstances, the taxpayer sustained a loss at the time of the compromise of the two suits in the amount of the account as carried on its books."

These principles are decisive of the case at bar. In the instant case petitioner was suing the officers and directors of The Hartman Corporation on behalf of the corporation and its stockholders to recover for waste, mismanagement and diversion of its assets. Until it was determined whether or not the corporation would recover in that action, and how much the recovery would be, the value of the petitioner's stock was undetermined and unknown. The ultimate loss, if any, was dependent upon the outcome of that action. Had the case gone to trial and resulted in a judgment in favor of the corporation directing the directors to account for the full amount of the damage caused by their mismanagement there might have been no loss to petitioner whatever. The action was actually settled in 1937. It was that settlement which, for the first time, fixed petitioner's loss. The deduction of the loss in 1937, therefore, was proper.

In *Cooley Butler & La Rue Butler* v. *Commissioner of Internal Revenue*, 45 B. T. A. 593, petitioner claimed that the stock of Idaho Copper Co. became worthless in 1937. The Commissioner claimed that the stock had become worthless prior to 1937. In 1927 the Idaho Copper Co. was placed in receivership. In 1929 the petitioner with the approval of the Court loaned certain money to Idaho Copper Co. to pay off receivership certificates. The loan was secured by the assets of the corporation. In 1931 the petitioner foreclosed the loan, and in 1932 he became

the purchaser of the assets which had been security for the note. The deed of foreclosure was executed in 1933. In 1932 certain stockholders of Idaho Copper Co. filed suit claiming the foreclosure was collusive and fraudulent. The Court decided that the foreclosure was not fraudulent and entered an interlocutory order which was consented to by all parties, which provided for obtaining a lessee for the property and if no lessee was obtained Idaho Copper Co. was to give petitioner a quit claim deed to the property. No lessee was found and on December 8, 1937, pursuant to the agreement embodied in the interlocutory decree, the Company executed a quit claim deed to petitioner. The Board of Tax Appeals decided that the stock of Idaho Copper Co. had a potential value which was not wiped out by the foreclosure sale of the property in 1932 and by the transfer of the property by sheriff's deed to petitioner in 1933, but continued until the final decree in the litigation and the consequent quit claim deed by the company to Cooley Butler in 1937. The Court held that not until the quit claim deed was given to Cooley Butler in 1937 could it have been definitely determined that there would be a loss or that the stock was worthless.

The rule is thus stated in *Olds and Whipple, Inc.* v. *Commissioner* (C. C. A. 2nd), 75 Fed. (2d) 272, 275:

> "A real loss is sustained when all chances or possibilities of collection have been effectively destroyed."

In *Sabath* v. *Commissioner of Internal Revenue,* 100 Fed. (2d) 569, the Court passed upon the question as to the year in which two stocks had become worthless. Petitioner had purchased stock in the Federal Paving Company. The Company had been engaged in paving roads in the states of Illinois and Indiana. Under certain of its contracts the Company lost a great deal of money and as a result became insolvent. In 1925 the Company pre-

sented a claim to the State Highway Department in the sum of $133,000. Thereafter the Company brought suit on its claim, which in 1928 was rejected by the Court of Claims. The Court held that the year in which the stock became worthless was the year in which the Court of Claims denied the Company's claim.

The second stock involved oil company stock which was purchased in 1918 by petitioner. The Company paid dividends until 1925. The company declined in its operations in 1925, 1926, 1927, 1928 and 1929. In 1929 the company abandoned its runs and had no substantial assets remaining over and above liabilities. Petitioner deducted his investment as a loss in 1929. The Board of Tax Appeals disallowed the deduction. The Circuit Court of Appeals reversed, saying, at page 573, *supra*:

> "The action of the petitioner is to be judged by the conduct of a reasonably prudent business man. He is presumed to know what any prudent person ought to know when facts are to be brought to his attention and to act honestly thereon. Avery v. Commissioner, 5 Cir., 22 F. 2d 6, 55 A. L. R. 1277. Only such losses are deductible under the statute as are fixed by identifiable events. United States v. S. S. White Dental Mfg. Co., 274 U. S. 398, 47 S. Ct. 598, 71 L. Ed. 1120. Here petitioner knew that his dividends had become of no considerable value; that the company was abandoning all further operation and that there were no substantial assets remaining. Perhaps he might have foreseen this outcome before 1929; but until that year the company was still in operation, producing oil, and a reasonably prudent businessman would not abandon his interest therein until he received further information that the holdings were abandoned. Under these facts there was no evidence to support a finding that petitioner had failed to prove that his loss was sustained in 1929. True it is that a small dividend of $300, apparently liquidating in character, was paid in 1922, but this in itself is not sufficient to support a finding that the loss was not sustained in the year 1929."

So in the instant case, petitioner did not abandon her interest in the stock of The Hartman Corporation. She employed counsel and advanced substantial sums of money in prosecuting what she considered a meritorious cause of action against the directors for waste and mismanagement. Like a "reasonably prudent business man" she continued to prosecute the Company's cause of action until she finally recovered in 1937 approximately forty per cent of the cost of her stock. In the face of this fact, how can it be reasonably inferred that the stock became worthless in 1932? We respectfully submit that the "identifiable event" from which it could be inferred or argued that the stock had no further value occurred in 1937 when the cause of action was settled. Until the cause of action was disposed of nobody could tell what the outcome of the case would be or how much would be realized upon the trial or settlement of the cause of action. It was the settlement in 1937 which was the "identifiable event" which for the first time fixed the amount of petitioner's loss, and it was that event which thereafter made petitioner's stock worthless.

Thus we have shown that petitioner's stock became worthless in 1937, at the time of the settlement of the cause of action against the directors. At that time petitioner released her interest in the Company's cause of action against the directors, and the Company had no other assets. We have also shown that petitioner invested time and money in prosecuting the Company's cause of action and therefore actually and honestly believed that her stock was not worthless prior to 1937. Applying either the subjective or objective test, petitioner was entitled to deduct from her 1937 income the sum of $19,940 as a loss on her stock in The Hartman Corporation.

The Circuit Court of Appeals relied upon two cases, *Commissioner* v. *John Thatcher & Son*, 76 F. 2d. 900, and *Niagara Share Corp.* v. *Commissioner*, 82 F. 2d. 208.

Neither of these cases is applicable to the instant case. In the *Thatcher* case there was no subsequent recovery by the taxpayer. The loss did not involve the question of the year in which a security became worthless but merely whether an operating loss of the taxpayer should have been deducted in the year in which it was sustained, or in a later year. The taxpayer claimed that the liability of a subcontractor to make good this loss justified the deduction of the loss in a later year as a bad debt. The Circuit Court of Appeals held that the loss could have been deducted in the year in which it was sustained. In addition, the Court pointed out that the taxpayer did not succeed in recovering anything on his claim against the subcontractor.

The Niagara Share case is likewise inapplicable. In that case the taxpayer sustained a loss. The taxpayer contended that certain persons were responsible to him as guarantors of said loss. The guarantors denied liability and their liability was sustained only by a divided court. In that case the taxpayer sought to deduct the loss in the year in which it had been sustained rather than in the year in which it was determined that he was unable to collect the amount from the guarantors. The Court held that the taxpayer could elect to deduct the loss in the year in which it was sustained and any amount recovered from the guarantors would be included as income in the year in which it was recovered. Thus, the decision is in no way applicable to the instant case.

CONCLUSION

For the reasons heretofore assigned, it is respectfully submitted that the decision below was incorrect and should be reversed.

Respectfully submitted,

LOUIS BOEHM,
Attorney for Petitioner.

Appendix

Revenue Act of 1936, c. 690, 49 Stat. 1648:

* * * * * * *

Sec. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * * * *

(e) Losses by Individuals.—In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

* * * * * * *

(2) if incurred in any transaction entered into for profit, though not connected with the trade or business:

* * * * * * *

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

ART. 23 (e)—1. Losses by individuals.—Losses sustained by individual citizens or residents of the United States and not compensated for by insurance or otherwise are fully deductible if * * * (b) incurred in any transaction entered into for profit, or * * * (d) if not prohibited or limited by any of the following sections of the Act: * * * section 117, relating to limitation on losses recognized by section 112 upon the sale or exchange of capital assets; * * *

In general losses for which an amount may be deducted from gross income must be evidenced by closed and completed transactions, fixed by identifiable events, bona fide and actually sustained during the taxable period for which allowed. Substance and not mere form will govern in determining deductible losses. * * *

ART. 23 (e)—4. Shrinkage in value of stocks.—A person possessing stock of a corporation can not deduct from gross income any amount claimed as a loss

merely on account of shrinkage in value of such stock through fluctuation of the market or otherwise. The loss allowable in such cases is that actually suffered when the stock is disposed of. If stock of a corporation becomes worthless, its cost or other basis as determined and adjusted under section 113 is deductible by the owner for the taxable year in which the stock became worthless, provided a satisfactory showing is made of its worthlessness. • • •

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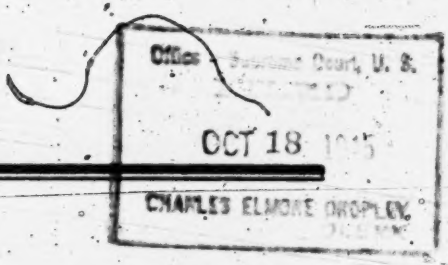

Supreme Court of the United States

OCTOBER TERM, 1945

No. 69

LILLIAN BOEHM,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITIONER'S REPLY BRIEF

LOUIS BOEHM,
Attorney for Petitioner.

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I

Respondent argues (brief p. 18) that "a test conditioned by the state of mind of the individual taxpayer would present insuperable obstacles to tax administration". However, the subjective test for which we contend is not dependent solely upon the "state of mind" of the taxpayer. The subjective test depends not merely on what the taxpayer may think concerning the worthlessness of his stock, but rather upon what the taxpayer *does* in support of his opinion, particularly in attempting to make good his loss or to salvage his investment. In other words, the state of mind of the taxpayer is proven by his overt *acts* and *conduct*. No greater administrative difficulties should be encountered in determining the facts from

the circumstances of the taxpayer's conduct than would be encountered in determining when stock has become worthless from the numerous circumstances which usually lead up to a corporation's insolvency. Whether we apply the objective or subjective test, each of them requires an examination of the facts and circumstances surrounding a particular situation. The subjective test, we respectfully submit, is the fairer test, for it considers the circumstances in the light of what a reasonable man believes and does at the time and as the situation develops, whereas the so-called objective test looks at the situation only in the cold light of subsequent events.

This Court itself adopted the subjective test in *Lewellyn* v. *Electric Reduction Co.*, 275 U. S. 243. In that case it was held that a loss resulting from a buyer's prepayment to a seller, who proved to be irresponsible, was not sustained when the money was paid but was deductible in the future year at the termination of litigation, establishing the inability to recover the payment. At page 247, the Court stated:

> "There is nothing in the findings from which we could conclude that the respondent in 1918 had ceased to regard his rights under the contract as having value or that there was then reasonable ground to suppose that efforts to enforce them would be fruitless."

II

Respondent's observation (p. 25) that "neither the taxpayer nor the Government should be afforded opportunity to select the year in which deductions are taken" has no application here. In the present case, the taxpayer did not select the year in which to take her loss. The year was selected for her by the settlement of the Graham suit, which she did not control and in which she was only one of nine plaintiffs. It was beyond her power to determine the year in which the settlement should be made. Respondent does not claim that the settlement was

not *bona fide*. He does not claim that defendants, who paid out a very substantial sum of money, did it collusively to enable petitioner to take her tax loss in a year of her selection. Nor would it have been possible to do this, as the rights of eight other stockholders were involved, whose tax status was separate and necessarily different from that of petitioner. Respondent speaks of considerations of practical administration in support of his contention. We respectfully submit, however, that justice cannot yield to expedience. Expedience may be the basis of legislative policy, but is hardly part of the judicial process.

The case of *Lambert* v. *Commissioner*, cited by respondent (p. 18) does not support this theory of expedience. The Court merely held that worthlessness was "to be arrived at by practical considerations". We submit that an honest opinion of a taxpayer evidenced by affirmative conduct is a "practical consideration" which should enter into any determination of worthlessness. The case of *Bartlett* v. *Commissioner*, also cited by respondent (p. 18) in support of his theory of convenience of tax administration contains absolutely no reference to this contention as an element in the determination of worthless stock losses.

III

Respondent refers to the fact that in 1942 Congress amended the Revenue Act to make deduction of "debts which became worthless within the taxable year" retroactive to taxable years beginning after December 1, 1938. It can hardly be argued, however, that a legislative enactment passed in 1942 is proof of legislative intent in 1937, five years previously. If that had been the legislative intent then, no doubt Congress would have passed the amendment at that time. That it did not is proof that it was not the legislative intent at that time.

Respondent also refers to the fact that at the same time Congress enacted a seven-year statute of limitations with respect to refund claims relating to deductions both on account of worthless stock losses and bad debts in place of the former three-year statute. The enactment of this legislation, in our opinion, gives legislative recognition to the dilemma in which taxpayers frequently found themselves as to when a worthless stock loss should be taken, and gave relief to the taxpayer who had mistakenly selected the wrong year. That statute, however, was not in force in 1937. At that time, the three-year statute was in effect. The amendment therefore availed the petitioner nothing.

Apparently even the respondent was in doubt as to the year in which petitioner's loss should have been taken, for in the Court below respondent argued that Hartman was "hopelessly insolvent" in 1932, and that in 1933 there was "very little" value to the taxpayer's stock (brief below, p. 16). If Hartman was hopelessly insolvent in 1932, the loss should have been taken in that year. If there was still some value in its stock in 1933, as respondent also stated in the Court below, then the loss should not have been taken in 1932, but in a subsequent year when *all* value had departed. Just what that year is respondent does not state. However, when petitioner attempted to take her loss in 1934, he denied the deduction. But whether it was in 1932 or 1933, as respondent intimates, when petitioner obtained her recovery, in 1937, the statute of limitations had already run and she could have obtained no relief by applying for a refund.

IV

It would be quite difficult, from the record in this case, to determine when the loss on petitioner's stock should have been taken, had it not been taken in 1937. The

complaint in the equity receivership suit, commenced in 1932, specifically alleged that the assets then were greater than the liabilities and that stockholders had a substantial equity in the Company and that it was to preserve this equity that the receivership was being applied for (R. 33). In 1933, when the physical assets of the corporation's principal subsidiary were sold, the cause of action against the directors was not included in the sale and still remained as an asset of the Corporation. The amount involved in that suit was far in excess of creditor's claims. What the outcome of that suit would be could not have been determined in 1933, or at any time thereafter before the suit was either tried or settled. Consequently, had petitioner attempted to take the loss on her stock in 1932 respondent might very properly have disallowed it because at that time there was no proof that the liabilities of Hartman were greater than its assets. Had petitioner attempted to take the loss in 1933, the Commissioner might with equal propriety have disallowed it for the reason that there was then pending a suit for an amount greatly in excess of the claims of creditors and that until that suit had been determined, it could not be established that petitioner had sustained a loss, or the amount of the loss. It is true that in an effort to protect her rights, petitioner attempted to take the loss in 1934. The Commissioner disallowed the loss then. The suit was then still pending and there was nothing to indicate that petitioner would sustain a loss on her stock, or what the amount of the loss would be. Recognizing the validity of the respondent's position, petitioner acquiesced in the disallowance of her loss in that year. That petitioner's attempt to take the loss in 1934 was not due to any lack of confidence in her lawsuit is evidenced by the fact that, far from abandoning the same, she continued thereafter vigorously to prosecute the action and to spend substantial sums of money thereon.

V

Respondent claims (brief, pp. 29-30) that the equity receiver's reports of 1934 and 1935 established that Hartman was insolvent and its stock was then worthless. These reports made by the equity receivers show the amount of *cash* on hand and the liabilities outstanding. Respondent states "the only other asset listed in these two receiver's reports was the Graham suit for which 'apparently' no value was stated". The stipulation does not disclose whether or not the receivers placed a value on this suit (R. 21). Whether they did or not, however, is immaterial.

In the first place, assuming that no value was stated, it could hardly be expected that a receiver (Martin L. Straus) who was himself a principal defendant in the suit, and his lawyer and co-receiver, would or could honestly state the value of that suit. In the second place, it would have been impossible for them to place a value on the suit. That could only have been done after a trial of the issues on the merits and a determination by the court. Assuming that the receivers attempted to place no value on the Graham suit, this constitutes no proof of its worthlessness and respondent's contention that Hartman's assets consisted only of the cash in the hands of the receivers is wholly specious.

VI

Respondent points to the Tax Court's statement that it knew nothing of the merits of the Graham suit, the probability of recovery or the assurance of the collectibility of a judgment. In this we respectfully submit, the Tax Court erred. The facts concerning the Graham suit were set forth at length in the complaint. It appeared therefrom that the defendant directors had caused

the Corporation to purchase 64,879 shares of its junior stock at an aggregate cost of $1,422,000 or $22 per share; that at that time, the Corporation had cash of only $1,385,000, less than the amount spent in acquiring the stock; that it had current liabilities of over $5,000,000; that it was then operating at a loss; that the purchase of such junior stock was in no way essential for the conduct of its business, but, on the contrary, had seriously depleted its working capital and impaired its ability to carry on its business (R. 58). The complaint further alleged that part of the stock so purchased was owned by the defendant directors who personally profited from its sale to the Corporation. The complaint further alleged that the stock purchased at $22 per share was resold to the defendant officers and directors and to employees at $16 per share (a loss of $6 per share, more than 25% of the purchase price), *with the option to such officers, directors and employees to resell it to the Corporation at the same price,* which option was thereafter exercised and the Corporation compelled to repurchase the stock when its market value had drastically declined. The stock was retired by the Corporation when its market value had shrunk to $3 per share C 59 .

From the foregoing recital of facts upon which the Graham suit is based, it is apparent that the action was founded on substantial grounds and was in no sense a suit without apparent merit. We respectfully submit that all that need be shown in a tax controversy of this nature is that the action was brought in good faith and that it had some apparent merit. It is unnecessary and, of course, impractical to try out the merits of the action in a tax controversy with the Government. If that were required it would consume weeks and perhaps months of the Court's time to no good purpose. It is sufficient to show that the action was based on substantial grounds and that it was prosecuted in good faith. That was am-

ply shown in the present case by the facts set forth in the complaint, and the further fact that the petitioner and the other stockholders spent a substantial sum of money in prosecuting the action. That the cause of action had merit is further evidenced by the fact that the defendants paid to the complaining stockholders the sum of $50,000, a substantial sum, not in settlement of the cause of action of the Corporation (for the settlement could not dispose of that), but in settlement of the damage which petitioner and the other complaining stockholders individually had sustained by reason of defendants' acts. This settlement represented a payment of approximately $12 per share on the 4400 class A shares owned by the plaintiffs in the Graham case.

The Court below also stated that the stipulated fact that the defendants were men of financial responsibility does not establish the collectibility of the recovery against them in excess of the claims of creditors. The stipulation recites (R. 23):

> "That the defendant directors were persons of financial responsibility, some of them being members of the banking firm of Hallgarten and Company, investment bankers of New York and Chicago, one of them being president and director of the May Department Stores, and one being president, director and principal stockholder of The Advance Corporation which owned a majority of the stock of the Eversharp Pencil Company."

It is a matter of common knowledge that Hallgarten & Company are one of the leading investment banking houses in the country; that May Department Stores is one of the largest and most prosperous department store chains in the country, whose stock is listed and actively dealt in on the New York Stock Exchange; that the Eversharp Pencil Company is the highly prosperous manufacturer of the well known brand of "Eversharp" pencils.

These facts, taken in conjunction with the stipulated fact that the defendants were men of financial responsibility, is sufficient to raise a presumption that the defendants had sufficient means to respond to a judgment against them in this action in an amount sufficient to leave something for stockholders. The very fact that they paid out the large sum of $50,000 in settlement of merely the individual claims of those stockholders complaining in the Graham suit, despite the fact that there were large claims of creditors ahead of them, is sufficient evidence that there was merit to the action, and that they had sufficient means to respond to a very substantial judgment in favor of the Corporation. It is most unlikely that these men would have paid out $50,000 in settlement of an individual claim of stockholders unless a much larger sum could have been collected from them in the suit of the Corporation. Furthermore, the Tax Court interpreted the stipulation much too narrowly. The stipulation provided that defendants "were persons of financial responsibility." This means, of course, that they had sufficient means to respond to *all* claims against them. Among those claims was the claim of The Hartman Corporation for mismanagement and waste, a claim which was greatly in excess of the claims of creditors of Hartman. If they did not have sufficient means to respond to all claims against them, the defendants would not have been persons of financial responsibility—they would have been insolvent. That was the intention and meaning of the stipulation. If there was any doubt as to its meaning the Tax Court should have granted petitioner's motion to reopen the case for proof as to the precise financial worth of these defendants (R. 17).

VII

Respondent stresses that there should be an identifiable event which determines when stock becomes worthless. We agree. Such a test supports the petitioner's position.

As we have previously stated, the Commissioner himself was in doubt whether the identifiable event which he thought fixed the worthlessness of petitioner's stock, occurred in 1932 or 1933. On the other hand, the identifiable event which actually fixed the worthlessness of petitioner's stock undoubtedly occurred in 1937, when she settled her lawsuit, and released her rights against the Hartman directors. After that her stock had no further value. This is indeed a practical, definitive and certain event, and is quite in contrast to the Commissioner's doubt as to whether the identifiable event occurred in 1932, when the receivers were appointed, or in 1933, when the assets of Hartman's principal subsidiary were sold.

VIII

Respondent admits that "taxpayer's appraisal is one of the factors in the ultimate determination of value or lack of value in a given tax year, and where a going business is concerned and there is 'hope that a business although involved might be saved and value in the stock established' (*Forbes* v. *Commissioner*, 62 F. 2d 571, 574 (C. C. A. 4th) it may become a factor of importance." Respondent, however, argues that the doctrine does not apply because "here there is no going concern involved" (Resp. brief, p. 22). We fail, however, to see the distinction in principle between an involved and failing business in which hope still exists that some value might be saved for the stock and a situation, such as is presented here, where a pending cause of action involving a sum far in excess of creditors' claims is being vigorously prosecuted, for the purpose of ultimately saving some value for the plaintiffs' stock. If, as the Commissioner concedes (brief, p. 22) that the "*taxpayer's* appraisal is one of the factors to be considered in the ultimate determination of value" then certainly the petitioner's *bona fide* appraisal of the

merit and value of her cause of action, an appraisal which turned out not only to be reasonable but to be correct, should have been considered by the Court below and given effect. Instead both the Court below and the Tax Court wholly ignored the taxpayer's honest and correct appraisal.

IX

Respondent argues (brief, pp. 28-30) that there were a number of identifiable events which justified the Tax Court in finding that the stock had become worthless prior to 1937. In support of his contention respondent says that "Hartman admitted the allegations of the bill of complaint seeking to place it in receivership". Respondent fails, however, to mention that the complaint, the truth of which Hartman admitted, specifically alleged that its principal operating subsidiary then had assets "exclusive of goodwill, of approximately $9,500,000 and liabilities of approximately $4,600,000," leaving a net value for the stock of almost $5,000,000; and that Hartman's, Inc., another subsidiary, had assets of $1,086,000 and liabilities of only $55,000, leaving net assets of over $1,000,000 (R. 26-27), making a total of approximately $6,000,000 of net assets in two of its subsidiaries. Respondent also fails to mention that in the bill of complaint, which Hartman admitted to be true, it was alleged that its assets and properties and those of its subsidiaries, were of great value, which could not be quickly sold without great loss and that upon being administered through the equity receivership would be sufficient to pay in full all liabilities and leave a surplus for the stockholders (R. 33).

X

Respondent has not attempted to reply to Point II of our main brief in which we demonstrated that the decision

of the Tax Court on agreed facts constituted a determination of law, reviewable in this Court. Respondent has not attempted to distinguish the cases cited in support of this contention. However, in passing, the respondent cites two cases which he contends limit the scope of judicial review of a decision of the Tax Court where the case was submitted on an agreed statement of facts (resp. brief, p. 26). These two cases do not support the respondent's contention. Quite to the contrary, one of the cases is in petitioner's favor.

In the first case, *San Joaquin Brick Co.* v. *Commissioner*, 130 F. 2nd 220, the question presented was whether the taxpayer could deduct a worthless stock loss in a particular year. The case was submitted on an agreed statement of facts which failed to contain certain proof necessary to satisfy the taxpayer's burden. The decision of the Circuit Court of Appeals, upholding the Tax Court in disallowing the loss, was not based on any theory of limited review of the decision of the Tax Court. To the contrary, the Circuit Court analyzed the stipulation of facts and discussed the requisite proof which was deemed lacking. As stated by the Circuit Court at page 226, *supra*: "The value of these properties is not shown. No balance sheets of any kind are in the record." Thus the Court reviewed the facts contained in the stipulation and based its decision not on any theory of limited review but on the failure of the stipulation to contain facts necessary to satisfy taxpayer's burden. In the other case cited by respondent, *Commissioner* v. *Horseshoe Syndicate*, 110 F. 2nd 748, the sole question was whether a certain syndicate more nearly resembled a corporation than it did a partnership under the Revenue Act of 1932. The facts had been presented to the Tax Court by stipulation. The Circuit Court of Appeals as in the *San Joaquin Brick* case proceeded to review the stipulation and upheld the Tax Court's decision. As to the scope of judicial review where the decision below was

based on an agreed statement of fact, Circuit Judge Hutcheson in a concurring opinion, specifically upheld petitioner's contention stating at page 750, *supra;*

> "It is, I think, *a question of law,* that is in the sense that no other conclusion could be drawn from the undisputed facts than the one the Board drew." (Italics ours.)

Thus in both cases cited by the respondent the appellate court reviewed the undisputed facts because they presented for review a question of law.

XI

Respondent contends that the recoupment "does not represent a recovery in the Graham suit" (p. 35) because no money was paid to the corporation or to its creditors. There is no merit in respondent's contention. This argument was rejected by the Circuit Court of Appeals below when it modified the decision of the Tax Court in respect of the $12,500 received upon the settlement and stated (80):

> "Clearly whatever the petitioner received in settlement was paid her as a stockholder and represented damages for destruction of the value of her stock caused by the allegedly illegal acts of the defendants".

The reason that the payment was not made into the corporate treasury was because the Corporation's cause of action had not been compromised or settled. The payment was merely paid in settlement of the *individual* claims of the stockholders who had joined in the Graham suit. *In no way did it constitute a settlement of the cause of action of the Corporation itself,* nor did it prevent either the Corporation or other stockholders from prosecuting a similar action in behalf of the Corporation. That settlement of claims of individual stockholders is

permissible under the New York practice has frequently been held.

Cook on Corporations, Vol. 4 (8th ed. 1923), 3286;
Beadleston v. *Alley*, 55 Hun 606 (7 N. Y. Supp. 747), appeal dismissed 119 N. Y. 659;
Dresdner v. *Goldman Sachs Trading Corp.*, 240 App. Div. 242 (269 N. Y. Supp. 360), leave to appeal denied, 241 App. Div. 745 (270 N. Y. Supp. 961);
Manufacturers Mutual Fire Ins. Co. v. *Hopson*, 176 Misc. 220 (25 N. Y. Supp. (2nd) 502); aff'd 262 App. Div. 731 (29 N. Y. Supp. (2nd) 139), aff'd 288 N. Y. 668, 43 N. E. (2nd) 71.

In *Cook on Corporations*, Vol. 4 (8th ed. 1923) 3286, the rule is thus stated:

> "It is a principle of equity practice, when a person brings a suit in behalf of himself and such others as may wish to come in who are similarly situated, that the complaining stockholder controls the case and may continue, compromise, abandon, or discontinue it at his pleasure."

In *Beadleston* v. *Alley*, 55 Hun 606 (7 N. Y. Supp. 747), appeal dismissed 119 N. Y. 659, the Appellate Division, Second Department, stated the rule at 7 N. Y. Supp. pages 748-749:

> "This suit was in behalf of the plaintiff and other stockholders, but it was, nevertheless, her suit, and wholly subject to her control. * * * It is thus far plain that the plaintiff had the right to settle her own grievance against the parties who had done her the alleged wrong; and it was none of the other stockholder's business how or by what means she did it."

Quite recently the question was again raised in *Manufacturers Mutual Fire Ins. Co.* v. *Hopson*, 176 Misc. 220;

aff'd 262 App. Div. 731, aff'd 288 N. Y. 668, where Mr. Justice Shientag stated the rule as follows, at page 223:

> "But this court is bound by a line of cases in New York to the effect that a minority stockholder may discontinue his action at any time before another stockholder has intervened or judgment has been entered. The exclusive control of the action belongs to him and he can settle his individual damages, leaving other shareholders to seek their remedy in a new action."

XII

The respondent cites *United States* v. *White Dental Co.*, 274 U. S. 398; *Commissioner* v. *Brown*, 54 F. 2d 563; *Commissioner* v. *Highway Trailer Co.*, 72 F. 2d 913; *Commissioner* v. *John Thatcher & Son*, 76 F. 2d 900; *Niagara Share Corp.* v. *Commissioner*, 82 F. 2d 208; *Cahn* v. *Commissioner*, 92 F. 2d 674; and *Hinrichs* v. *Helvering*, 95 F. 2d 117 (p. 35) in support of his contention that a subsequent recovery does not establish that stock was not worthless in a prior year. These cases do not support the contention. In three of the cases (*Commissioner* v. *John Thatcher & Son*, *Commissioner* v. *Highway Trailer Co.* and *Hinrichs* v. *Helvering*, *supra*), there was no subsequent recovery. In the other four cases (*United States* v. *White Dental Co.*, *Commissioner* v. *Brown*, *Niagara Share Corp.* v. *Commissioner* and *Cahn* v. *Commissioner*, *supra*) there was a subsequent recovery but it was held that the *taxpayer* could elect to deduct the loss in the prior year and was not obliged to wait for the possible recovery. The case of *Niagara Share Corp.* v. *Commissioner*, cited by the respondent in this latter group, is discussed at page 33 of our main brief.

XIII

The concluding sentence in respondent's brief contains a footnote reference to the case of *Leiper* v. *Commissioner,* (1941-42 P-H B. T. A., Memorandum Decisions, par. 42, 211) which held that the Hartman class B stock had become worthless before 1937. The decision in the *Leiper* case, however, has no bearing on the decision in the instant case because (1) the basis on which the taxpayer in the *Leiper* case claimed her stock became worthless in 1937, differs from the basis on which the petitioner claims her stock became worthless in that year; (2) the evidence presented in the *Leiper* case differs materially from the facts stipulated in the case at bar; (3) certain evidence which the Court in the opinion in the *Leiper* case found was lacking is contained in the stipulation of facts submitted herein; (4) the *Leiper* case involved class B or junior stock of The Hartman Corporation, whereas the instant case involved class A stock; and (5) the petitioner in the *Leiper* case commenced no action against the directors but relied merely on another case to which she was not a party (not the Graham suit) which had been commenced but had been dismissed for lack of jurisdiction; and finally (6) Leiper recovered nothing on her stock.

The ruling of the Tax Court with respect to the worthlessness of stock of a company in a previous case has no bearing upon its decision in another case. Each case stands upon its own facts and upon the record presented to the Court. Due to the fact that the proof presented in each case differs from that presented in other cases, each decision must be based solely upon the record before it.

Mary S. Peabody, 38 B. T. A. 1086;
Rex E. Beach v. *Commissioner,* Docket #107408 (B. T. A.);

Morton L. Fearey, Docket #110614 (B. T. A.); *Julian M. Livingston*, 46 B. T. A. 538, 547.

In the case of *Mary S. Peabody*, 38 B. T. A. 1086, *supra*, the Commissioner disallowed a deduction of $31,156.15 as a loss on account of the worthlessness of the preferred and common stock of Middle West Utilities Co. The Commissioner claimed that this stock did not become completely worthless in 1932 and relied on a previous ruling of the Board of Tax Appeals that the stock had not become worthless in 1932. After reviewing the evidence presented before it, the Board of Tax Appeals concluded that the petitioner was entitled to take the deduction in 1932, since it held that the stock had become worthless in that year, declaring at page 1087:

> "The Commissioner now relies almost entirely upon the decision of the Board in the case of George H. Horning, 35 B. T. A. 897. Horning was there claiming a loss on common and preferred stock of the Middle West Utilities Co. on the ground that it became worthless in 1932. Thus the issue there was identical with the issue here. The headnote and the statement of the question in the opinion indicate that the petitioner failed for lack of proof. *Each case of this kind must be decided upon the evidence presented in that particular case.* All of the evidence introduced in the Horning case to show worthlessness in 1932 has been introduced here, *together with important additional evidence.*" (Italics ours.)

In the case of *Rex E. Beach*, Docket No. 107408, *supra*, the petitioner acquired certain common stock of the same Middlewest Utilities Co., prior to 1932, at a cost of $9,765.90. During the taxable year 1938 he sold the stock for $41.38, sustaining the loss of $9,724.52. Petitioner claimed a deduction of 50% on this loss under Section 23 of the Revenue Act of 1938. The Commissioner claimed that the common stock of the company became worthless in 1932, relying upon the decisions of the Board in the *Pea-*

body case, *supra*, and the case of *Benjamin and Julia F. Mahler*, Docket Nos. 88448 and 90482. The Board, nevertheless, held that upon the evidence presented to it in the *Beach* case, there was a continuing market for the stock from 1932 to the date of sale in 1938 and that the loss was properly taken in 1938.

Respectfully submitted,

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No. 1254

In the Supreme Court of the United States

OCTOBER TERM, 1944

LILLIAN BOEHM, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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OPINIONS BELOW

The memorandum opinion of the Tax Court (R. 81–89) is not reported. The opinion of the Circuit Court of Appeals (R. 102–106) is reported at 146 F. 2d 553.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered February 10, 1945. (R. 122.) The petition for a writ of certiorari was filed May 10, 1945. The jurisdiction of this Court is invoked under

Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the Tax Court erred in finding as a fact that certain stock with respect to which the taxpayer claimed a loss deduction in 1937 did not become worthless in that year.

STATUTE INVOLVED

Revenue Act of 1936, c. 690, 49 Stat. 1648:

> SEC. 23. DEDUCTIONS FROM GROSS INCOME.
>
> In computing net income there shall be allowed as deductions:
>
> * * * * *
>
> (e) *Losses by Individuals.*—In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—
>
> * * * * *
>
> (2) if incurred in any transaction entered into for profit, though not connected with the trade or business;
>
> * * * * *

STATEMENT

In 1929 the taxpayer purchased 1,100 shares of the Class A stock of The Hartman Corporation, hereinafter called Hartman, for $32,440. Hartman was incorporated in 1916 in the State of Virginia and acquired the capital stock of the Hartman Furniture and Carpet Company, hereinafter called Hart-

man (Illinois) and its affiliates, which were engaged in the business of selling furniture, carpets and household goods. (R. 82.)

The Hartman balance sheet of December 31, 1931, and a statement of its board of directors dated April 4, 1932, addressed to its stockholders, indicated the adverse business effect of the depression and the corrective measures being taken by the directors. (R. 57–62, 82.) A letter from the president of Hartman to its stockholders, dated May 4, 1932, stated that business had not shown any improvement. (R. 64, 82.)

In June, 1932, equity receivers were appointed for Hartman by the District Court of the United States for the Northern District of Illinois, Eastern Division. The receivers entered into possession of the property of Hartman and continued its business of buying and selling furniture and other household articles from the time of their appointment until on or about May 26, 1933. (R. 82.)

In 1933 the stockholders of Hartman were given the right to subscribe for debentures and capital stock of Hartman's, Inc., a new corporation organized in that year to purchase at a bankruptcy sale the assets of Hartman (Illinois), the wholly-owned subsidiary of Hartman. The taxpayer did not subscribe, and acquired no interest in that company. (R. 83.)

On August 10, 1934, the receivers of Hartman filed a report listing as assets $39,593.13 in cash and a suit pending against the directors (hereinafter

referred to as the Graham suit), and as liabilities, total outstanding claims of $707,430.67. They recommended that claims totaling $630,574.57 be allowed. The court approved the report and also awarded $8,500 as compensation to receivers and attorneys. (R. 83.) In a second report filed July 11, 1935, the liabilities were again listed at $707,430.67, but the assets were listed as less than before or $27,192.51 in cash, and the Graham suit. The receivers recommended that a four per cent dividend be paid on the claims of $630,574.57 allowed. The court adopted the report and recommendations, and on August 26, 1935, one of the receivers was released from further duties. (R. 83.)

On September 30, 1937, the remaining receiver filed a final report. The sole remaining asset was cash in the amount of $1,909.94. Claims totaled $630,574.57. It was recommended that compensation totaling $900 be allowed the receiver and counsel and that the remainder be distributed to the creditors. The court adopted the recommendations and discharged the receiver by an order dated September 30, 1937. (R. 84.)

The Graham suit was instituted December 16, 1932, in the Supreme Court of the State of New York. The plaintiffs were the taxpayer and eight other stockholders of Hartman. The defendants were the Hartman corporation and nine members of the company's board of directors, all of whom were financially responsible and several of whom

were prominent businessmen. The plaintiffs sued (R. 84)—

> on behalf of themselves as stockholders of The Hartman Corporation and on behalf of the said Company and all other stockholders of said Company similarly situated, who may join with the plaintiffs in, and contribute to the expenses of this suit.

The plaintiffs charged the defendant directors with waste, extravagance, mismanagement, neglect and fraudulent violation of their duties as officers and directors, demanded an accounting and that the defendants pay into the treasury of the corporation the amount of the loss and damage sustained by it by reason of their wrongful acts. (R. 85.) During the years 1933 to 1936, inclusive, extensive examinations were made of several of the defendants. The taxpayer and her co-plaintiffs paid expenses and counsel fees, pursuant to an order of the court, of about $800, and the plaintiffs expended approximately $2,000, exclusive of fees, in defraying expenses of counsel, stenographic costs and printing charges. (R. 86.)

At the conclusion of the examinations and shortly before the trial, negotiations were commenced for a settlement of the action and on February 20, 1937, a settlement was consummated. Under its terms the defendant directors paid the taxpayer and the other plaintiff stockholders $50,000 in full discharge of their claims and cause of action, and the taxpayer and the other stockholders released all their rights and claims arising out of the acts committed by the defendants

as alleged in the complaint. The suit was dismissed on May 14, 1937. (R. 86.) The taxpayer's proportionate share of the $50,000, after payment of counsel fees and expenses, amounted to $12,500. (R. 86–87.)

The taxpayer claimed a deduction from gross income in her 1934 income tax return in the amount of $32,302 as a loss due to the worthlessness of her 1,100 shares of Hartman Class A stock. The Commissioner denied the deduction on the ground that the stock did not become worthless in 1934. (R. 87.)

In her income tax return for 1937 the taxpayer claimed a deduction from gross income in the amount of $19,940 as a loss due to the worthlessness of her Hartman Class A stock, which amount represents the difference between the cost of such stock and the $12,500 paid taxpayer in the settlement referred to above. The Commissioner denied the deduction. (R. 87.) The Tax Court found as a fact that the taxpayer's stock in Hartman did not become worthless in 1937 (R. 87) and sustained the Commissioner (R. 87–88). The Circuit Court of Appeals affirmed. (R. 102–106.)

ARGUMENT

The question here presented, and the conflict asserted by the taxpayer, are the same as in *Superior Coal Co.* v. *Commissioner*, No. 950, this Term, in which certiorari was denied on April 2, 1945.

The Tax Court here found that the taxpayer's stock did not become worthless in 1937 (R. 87), and the court below correctly held that this finding

was supported by substantial evidence. (R. 103.) The determination of the Tax Court is therefore dispositive of the sole issue in the case, for the question whether property became worthless in a particular year is a question of fact exclusively within its province. *Lucas* v. *American Code Co.*, 280 U. S. 445; *United States* v. *White Dental Co.*, 274 U. S. 398.

Here, as in the *Superior Coal Co.* case, no substantial conflict exists with the decision of the Court of Appeals for the District of Columbia in *Smith* v. *Helvering*, 141 F. 2d 529. Assuming, *arguendo*, that there is some validity in the "subjective test" propounded in the *Smith* case for determining the tax year in which property becomes worthless, the decision of the Tax Court is not at variance with that rule, and its application here would call for no different result. The "subjective" factor upon which the taxpayer relies is that she expended some fraction of $2,800 as a stockholder in defraying the expenses of the Graham suit. The record does not indicate that the Tax Court disregarded this factor; on the contrary, the Tax Court made a finding upon it. (R. 86.) Other facts found by the Tax Court, however, clearly indicate subjective determination of worthlessness by the taxpayer long before 1937; the taxpayer claimed a loss deduction asserting the worthlessness of the stock here involved in her income tax return for 1934. (R. 87.) Even if objective facts were to be eliminated from consideration, the subjective factors would merely lead to conflicting inferences of fact; and it was the exclusive function

of the Tax Court to choose between them. In any view of the matter, the decision of the Tax Court was supported by substantial evidence and is correct.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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No. 69

In the Supreme Court of the United States

OCTOBER TERM, 1945

LILLIAN BOEHM, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT

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BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The memorandum opinion of the Tax Court (R. 62–68) is not reported. The opinion of the Circuit Court of Appeals (R. 76–80) is reported in 146 F. 2d 553.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on February 10, 1945 (R. 92). The petition for a writ of certiorari was filed on May 10, 1945, and granted on June 11, 1945 (R. 93). The jurisdiction of this Court is invoked under

Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether, as found by the Tax Court, certain stock, with respect to which taxpayer claimed a loss deduction in 1937, did not become worthless in that year.

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved may be found in the Appendix, *infra*, pp. 38–39.

STATEMENT

The facts were stipulated (R. 20–61) and the Tax Court based its findings upon the stipulation (R. 62).

The Hartman Corporation (hereafter called "Hartman") was a Virginia company, organized in 1916 to acquire the capital stock of Hartman Furniture and Carpet Company, an Illinois corporation, and its affiliates, engaged in the business of selling furniture, carpets, and household goods (R. 20). Through subsidiary companies, Hartman operated a chain of retail stores, principally in the Middle West, for the sale of this type of merchandise. The Hartman Corporation was authorized to issue two classes of stock, known as

Class A and Class B stock.[1] (R. 56.) In 1929 taxpayer purchased 1,100 shares of Class A stock of Hartman for $32,440 (R. 20).

Subsequent to April 4, 1932, taxpayer received a letter of that date from Hartman issued by order of its directors, reporting policies adopted and procedures followed as a consequence of the then current business depression, discussing shrinkage of sales, decline in worth of assets, unprecedented credit and corporate losses, and stressing the reduction of operating costs and loans payable, and submitting its balance sheets as of December 31, 1931. The balance sheet showed assets and liabilities of $15,401,097.97 and a total net

[1] The rights and privileges of these two classes of stock are described in the bill of complaint for appointment of a receiver of Hartman, included in the stipulation of facts, as follows (R. 25-26):

"The shares of Class 'A' stock are entitled to cumulative dividends at the rate of $2.00 per share per annum, and no more, payable in preference to dividends under Class 'B' stock, and redeemable at $30.00 per share and accrued dividends. Upon the dissolution of the corporation the Class 'A' stock is entitled to share equally and ratably with Class 'B' shares in the distribution of the assets until the holder of each share of Class 'A' stock shall have received $30.00 per share plus accrued dividends. The shares of Class 'B' stock have a stated value of $10.00 a share, and are entitled to dividends only after cumulative dividends at the rate of $2.00 per share per annum have been paid on Class 'A' stock, and said Class 'B' stock is entitled to share equally with Class 'A' stock in the distribution of the assets of the corporation until Class 'A' stock shall have received $30.00 per share and accrued dividends, and thereafter all assets of said corporation are to be distributed ratably among the holders of Class 'B' stock without participation with the holders of Class 'A' stock."

worth of $9,410,659.50. (R. 20, 42–47.) On May 4, 1932, Martin L. Straus, its president, sent another letter to stockholders, informing them that business had not shown any improvement and outlining the measures being taken to counteract the existing unfavorable business conditions (R. 47–49). In the following month, on June 16, 1932, Mr. Straus and Elias Mayer were appointed equity receivers for the corporation by the United States District Court for the Northern District of Illinois, upon the admission by Hartman of the allegations of a bill of complaint by a creditor (R. 38–42). The bill set forth that Hartman and its subsidiary companies sustained losses in 1931 from closing stores amounting to $761,648 and from necessary liquidation approximately $1,150,000 (R. 28–29); and alleged, in addition, that Hartman sustained operating losses in 1930 in the amount of $1,830,000; in 1931, $2,076,266.39; from January, 1932, to June 16, 1932, $400,000 (R. 29); the corporation's business was then being operated at a great financial loss (R. 29); it was unable to meet and pay its obligations due and to become due (R. 29); but that if its assets were administered through a receivership they would be sufficient to pay in full all Hartman liabilities, leaving a surplus for its stockholders (R. 33).

On December 16, 1932, a stockholders' derivative action (hereinafter called the Graham suit)

was instituted in the Supreme Court of the State of New York against the corporation and nine members of its board of directors, some of whom were also officers (R. 22, 55, 56–57). All of the individual defendants were financially responsible and several were prominent business men (R. 23). The plaintiffs were taxpayer and eight other stockholders of the corporation, in the aggregate representing 4,407 shares of Class A stock and 115½ shares of Class B stock[2] (R. 55–56). They brought the suit (R. 55)—

> on behalf of themselves as stockholders of The Hartman Corporation, and on behalf of the said Company and all other stockholders of said Company similarly situated, who may join with the plaintiffs in, and contribute to the expenses of, this suit * * *.

The complaint charged the individual defendants with waste, extravagance, mismanagement, neglect, and the fraudulent violation of their duties as officers and directors, with the issuance of false letters, statements and reports to the stockholders relating to the assets, liabilities and financial condition of the corporation and with concealing its true state and condition from the stockholders, including the plaintiffs (R. 57–58, 60). The relief requested was as follows (R. 61):

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[2] Prior to 1930 (R. 56) and in June 1932 (R. 25, 37) there were approximately 60,000 Class A shares outstanding and more than 335,000 Class B shares.

1. That the defendants and each of them, except The Hartman Corporation, be directed to account to the defendant Corporation for their official conduct as officers and/or directors thereof, as the case may be, in the management and disposition of the property and affairs of the said Corporation, and in respect to all of the matters set forth in this complaint;

2. That the liability of the defendants and each of them, be ascertained and determined, and that they be adjudged and decreed to pay into the Treasury of the defendant Corporation the amount of the loss and damage which shall be found to have been sustained by the Corporation by reason of their aforesaid wrongful acts and conduct;

3. That this Court make and award suitable allowance to the plaintiffs for counsel fees and other necessary disbursements incurred in the prosecution of this action on behalf of the defendant Corporation and stockholders, and that it be decreed that the defendant Corporation pay the same to the plaintiffs, and that the plaintiffs have judgment therefor, together with the costs and taxable disbursements of this action.

4. That the plaintiffs have such other and further relief as may be just, equitable, and proper.

The receivers continued to operate Hartman until May 26, 1933 (R. 20). As of that day, a newly organized Delaware corporation called

"Hartman's, Inc." purchased at a bankruptcy sale the assets of Hartman Furniture and Carpet Company, the wholly owned subsidiary of Hartman, for the sum of $501,000 in cash and an agreement to procure a waiver of certain inter-company claims against the bankrupt estate. The stock of the new company was issued to creditors of the subsidiary in settlement of claims. Stockholders of Hartman were given the right to subscribe for stock and debentures of the new company. However, taxpayer did not exercise this right and did not acquire any interest in the new company in 1933 or afterwards. (R. 21.)

Three reports were filed with the federal district court by the receivers of Hartman. In the first report filed and approved on August 10, 1934, assets were listed as $39,593.13 in cash and the Graham suit; liabilities, consisting of outstanding claims, were stated to aggregate $707,430.67. The receivers recommended that claims in a total of $630,574.57 be allowed. The court awarded $3,500 compensation to each of the receivers and $5,000 as attorneys' fees. The receivers filed a second report on July 11, 1935, listing as assets $27,192.51 in cash and the Graham suit pending against the directors; and as liabilities, the same amount, namely, $707,430.67, representing the total outstanding claims set forth in their first report. They recommended that a dividend of 4% be paid on the allowed claims of $630,574.57, and that one claim amounting to $176,856.10 be disallowed. By

an order of the same date the court adopted their report and recommendations. On August 26, 1935, one of the two receivers was released from further duties. (R. 21.)

The remaining receiver filed his final report with the court on September 30, 1937. He showed as the sole remaining asset, cash in the amount of $1,909.94; claims totaled $630,574.57. On the same date the court discharged the receiver, allowed him and counsel compensation totaling $900, and provided that the balance of assets be distributed to the creditors. (R. 21–22.)

In her income tax return for 1934, taxpayer claimed a deduction from gross income in the amount of $32,302 as a loss due to the worthlessness of her 1,100 shares of Class A stock in the corporation. The deduction was denied by the Commissioner on the ground that the stock did not become worthless in the year 1934. (R. 22.)

During the years 1933 to 1936, inclusive, extensive examinations in the Graham suit were made of certain of the defendants. Many hundreds of pages of testimony were taken and numerous exhibits were offered in evidence. Pursuant to an order of the New York Supreme Court, taxpayer and her co-plaintiffs paid counsel fees, transportation, and hotel expenses of certain of the defendants' attorneys, amounting to approximately $800, and expended approximately $2,000, exclusive of fees, in defraying disbursements of their counsel

while attending the examinations, in stenographic costs and printing charges. (R. 22–23.)

At the conclusion of the examinations and shortly before trial, negotiations were commenced for settlement of the action, and on February 20, 1937, a settlement was consummated. Under its terms the defendant directors paid taxpayer and her co-plaintiff stockholders the sum of $50,000 in full settlement and discharge of their claims and cause of action. In connection with the settlement, taxpayer and the other stockholders released all their rights and claims arising out of the acts committed by the defendants as alleged in the complaint. (R. 23.) The suit was dismissed on May 14, 1937 (R. 66). Taxpayer's proportionate share of the $50,000, after payment of counsel fees and expenses, amounted to $12,500. At the time of the settlement the assets of the corporation consisted of $1,909.94 in cash and the Graham suit, and its liabilities amounted to $630,574.57, representing the claims allowed by the federal district court. (R. 23.)

In her income tax return for 1937, taxpayer claimed a deduction from gross income in the amount of $19,940, as a loss due to the worthlessness of her stock in the corporation, being the difference between $32,440, its purchase price, and the $12,500 received pursuant to the settlement. The Commissioner denied the deduction and included in her gross income for the year 1937 this

sum of $12,500. (R. 23.) At no time has taxpayer received any deduction from gross income in the determination of her income tax liability by reason of her investment in the Hartman stock (R. 24).

Taxpayer raised two issues in the Tax Court: (1) whether her stock in the corporation became worthless in 1937, as she claimed; (2) whether the Commissioner properly included in her gross income for 1937 the sum of $12,500 paid as a result of the settlement of the Graham suit (R. 62). The Tax Court found in favor of the Commissioner on both issues (R. 67–68), denied taxpayer's motion for a rehearing (R. 2, 17–19), and redetermined deficiencies for 1937 in the sum of $5,957.86[3] (R. 69).

The court below affirmed the Tax Court as to the first question, but reversed as to the second, holding that the sum of $12,500 must be regarded as a capital item in reduction of loss and that the Tax Court had erred in ruling that taxpayer had not proved the payment was not income (R. 76–80). A petition by taxpayer for rehearing (R. 81–89) was denied (R. 91). Taxpayer alone sought certiorari in this Court.[4]

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[3] Other issues raised in taxpayer's petition were disposed of by stipulation prior to the hearing in the Tax Court (R. 24).

[4] Thus, the balance of the tax deficiency determined by the Tax Court remaining in controversy amounts approximately to $3,000.

SUMMARY OF ARGUMENT

I.

Taxpayer's contention that, under Section 23 (e) of the Revenue Act of 1936 permitting deductions of "losses sustained during the taxable year", the question to be determined is not whether her stock actually became worthless before 1937 but whether she honestly believed that it had some value until settlement of the litigation, finds express refutation in the language of the statute and of regulations having the force of law. The legal test prescribed is an objective and not a subjective one. The question is when the stock in fact became worthless, not when taxpayer learned that it was worthless or when she honestly believed it became worthless. The regulations have long generally required deductible losses to be fixed by identifiable events. The requirement that losses be deducted in the year in which they are actually sustained calls for a practical test, since a test conditioned by the state of mind of the individual taxpayer would present insuperable obstacles to tax administration.

The language of the statute does not suggest a subjective test and is to be contrasted with that used in the bad debt provision where deduction was permitted when "ascertained to be worthless and charged off within the taxable year." Section 23 (k), Revenue Act of 1936. Even under the bad debt provision, there has been a difference of judicial opinion as to whether the test

was purely subjective. This caused constant administrative difficulties, and by the Revenue Act of 1942, Section 124, Congress amended the bad debt provision to permit deduction only of "debts which became worthless within the taxable year." Thus, even in the case of bad debts, Congress now prescribes an objective rather than a subjective test. While taxpayer's appraisal is one of the factors to be considered in the ultimate determination of value or lack of value in a given tax year, especially where a going business is concerned, taxpayer's appraisal is but one of the factors to be considered, and where there are other relevant factors it is the function of the Tax Court to weigh all of the factors in the case, and the belief of taxpayer as to value is certainly not necessarily the controlling element.

II

The finding of the Tax Court that the loss was not in fact sustained in the taxable year was correctly held by the court below to be supported by substantial evidence. Plainly a pure question of fact is involved, although the Tax Court based its findings upon stipulated facts. The choice among conflicting inferences which fairly may be drawn from the stipulated facts lies within the exclusive jurisdiction of the Tax Court. Loss deductions, like other deductions, are matters of legislative grace and the burden is upon the taxpayer to establish the loss in the year in which the deduc-

tion is claimed. Here there was a succession of identifiable events occurring many years before the taxable year, which taken separately or in combination proved the stock to be completely worthless and sustain the finding of the Tax Court. The loss must be taken in the year in which it is actually sustained, even though it is possible that there may be some recovery on the investment in the indefinite future. Even though such possibility at some later date actually results in substantial recovery, the cases hold that it is the fairer course to allow a taxpayer to deduct the loss in the year when suffered and to pay a tax on the amount of the loss recovered in the later year. Moreover, as a matter of fact, what taxpayer here recouped obviously does not represent a recovery in the Graham suit since under the theory of that derivative action the recovery would necessarily have been paid to the corporation's creditors or divided among all the stockholders. Indeed, taxpayer's present claim is inconsistent with her previous attempt to deduct the loss in 1934 and hence even on the basis of a subjective appraisal, the evidence is conflicting and the Tax Court surely could reasonably find against taxpayer. Whether in a given case the likelihood of recoupment is real, or as here found, speculative, is peculiarly a fact question for determination by the Tax Court, which here on substantial evidence was resolved against taxpayer.

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ARGUMENT

I

THE STATUTE REQUIRES THE LOSS TO BE DEDUCTED IN THE TAXABLE YEAR IN WHICH IT WAS IN FACT SUSTAINED

The applicable statute permits deductions of "losses sustained during the taxable year and not compensated for by insurance or otherwise" (Section 23 (e), Revenue Act of 1936, Appendix, *infra*, p. 38). The identical language is found unchanged in successive Revenue Acts for many preceding years beginning with the Revenue Act of 1918, c. 18, 40 Stat. 1057, Section 214 (a) (4),[5] was re-enacted in the Revenue Act of 1938, c. 289, 52 Stat. 447, Section 23 (e), and is presently continued in the Internal Revenue Code, Section 23 (e). Moreover, long standing Treasury Regula-

[5] Indeed, the provision may be traced to the Civil War income tax legislation, Act of March 2, 1867, c. 169, 14 Stat. 471, Section 13, permitting deduction of "losses actually sustained during the year arising from fires, shipwreck, or incurred in trade". The Act of August 27, 1894, c. 349, 28 Stat. 509, Section 28, permitted deduction of—

"losses actually sustained during the year, incurred in trade or arising from fires, storms, or shipwreck, and not compensated for by insurance or otherwise, * * *"

The same language was repeated in the Income Tax Act of 1913, c. 16, 38 Stat. 114, 166, Section II B. The Revenue Act of 1916, c. 463, 39 Stat. 756, Section 5 (a), Fourth, read—

"Losses actually sustained during the year, incurred in his business or trade, or arising from fires, storms, shipwreck, or other casualty, and from theft, when such losses are not compensated for by insurance or otherwise: * * *"

tions expressly mark out the Congressional intent, thus repeatedly manifested over a period of many years, that deductible losses must not only be "bona fide" but also "actually sustained during the taxable period for which allowed." (Treasury Regulations 94, Art. 23 (e)–1, Appendix, *infra*, pp. 38–39.)* On familiar principles, Treasury Regulations, long continued without substantial change, and applying to an unamended or substantially re-enacted statute, are deemed to have received Congressional approval and have the force of law. *Taft* v. *Commissioner*, 304 U. S. 351, 357; *Helvering* v. *Winmill*, 305 U. S. 79, 83; *Douglas* v. *Commissioner*, 322 U. S. 275, 281–282.

Thus, taxpayer's contention, as stated in the opinion below (R. 79)—

> that the question to be determined is not whether the stock actually became worthless before 1937 but whether she honestly believed that it had some value until settlement of the litigation

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*The complete sentence in the Regulations reads:

"In general losses for which an amount may be deducted from gross income must be evidenced by closed and completed transactions, fixed by identifiable events, bona fide and actually sustained during the taxable period for which allowed."

The identical language is contained in Article 23 (e)–1 of Regulations 86, under the Revenue Act of 1934; Article 23 (e)–1 of Regulations 101, under the Revenue Act of 1938; Section 19.23 (e)–1 of Regulations 103, under the Internal Revenue Code; and Section 29.23 (e)–1 of Regulations 111, under the Internal Revenue Code.

finds express refutation in the language of the statute and of the Regulations, having the force of law. On the contrary, these required the court below to approve "the objective rather than the subjective test in determining the worthlessness of stock" (R. 79); the prescribed legal test includes both *bona fides* and loss actually sustained during the taxable period.

The Regulations further contain specific provision covering worthless stock losses. Here it is again made clear that it is only losses in fact that are deductible. Thus, "paper" losses are excluded. A taxpayer may not claim a loss "merely on account of shrinkage in value of such stock through fluctuation of the market or otherwise." (Treasury Regulations 94, Art. 23 (e)–4, Appendix, *infra*, p. 39.) In such cases the loss is "that actually suffered when the stock is disposed of." (Treasury Regulations 94, Art. 23 (e)–4.) If, before being disposed of, the stock becomes worthless, its cost or other basis (Art. 23 (e)–4)—

> is deductible by the owner for the taxable year in which the stock became worthless, provided a satisfactory showing is made of its worthlessness.

Hence, plainly the test contemplated is neither the year in which the taxpayer learned that it was worthless nor that in which she honestly believed it became worthless.

The treatment of theft and embezzlement losses illustrates the objective concept for loss deduc-

tions. Thus Regulations 94, Article 43–2, provides "A loss from theft or embezzlement occurring in one year and discovered in another is ordinarily deductible for the year in which sustained." *First Nat. Bank of Sharon, Pa.* v. *Heiner,* 66 F. 2d 925 (C. C. A. 3d); *Borden* v. *Commissioner,* 101 F. 2d 44 (C. C. A. 2d); see also *Burnet* v. *Huff,* 288 U. S. 156. Cf. *Boston Consol. Gas Co.* v. *Commissioner,* 128 F. 2d 473 (C. C. A. 1st), holding that an exception should be made where the taxpayer could not allocate the embezzled funds to particular years under another provision of the same Article, expressly authorizing an amended return for the prior year, including the amount of loss among deductions from gross income and a claim for refund of the excess tax paid by reason of the failure to deduct the loss in the original return. This machinery was available to the instant taxpayer. The significant point is that the loss is regarded as having been sustained only in the year when it in fact occurred; a deduction is allowable in any other year only when necessary to reflect income correctly, and the state of mind of the taxpayer is immaterial.

For like reason the Regulations require "in general", deductible losses to be "fixed by identifiable events." (Regulations 94, Article 23 (e)–1.) As expressed by the Board of Tax Appeals in *Morton* v. *Commissioner,* 38 B. T. A. 1270, 1278, affirmed, 112 F. 2d 320 (C. C. A. 7th):

> Such events are called "identifiable" in that they are likely to be immediately known by everyone having an interest by way of stockholdings or otherwise in the affairs of the corporation; but, regardless of the adjective used to describe them, they are important for tax purposes because they limit or destroy the potential value of stock.

Cf. *United States* v. *White Dental Co.*, 274 U. S. 398, 401. Thus, here again the controlling factor is external. The evidence is equally available to the officers of the Treasury and to the taxpayer, and does not depend upon the mental processes of any individual. As this Court said in *Lucas* v. *American Code Co.*, 280 U. S. 445, 449, in language often quoted:

> The general requirement that losses be deducted in the year in which they are sustained calls for a practical, not a legal test.

The general requirement of an identifiable event calls for a practical test, since a test conditioned by the state of mind of the individual taxpayer would present insuperable obstacles to tax administration. *Lambert* v. *Commissioner*, 108 F. 2d 624 (C. C. A. 10th); *Bartlett* v. *Commissioner*, 114 F. 2d 634, 638 (C. C. A. 4th).

The choice of statutory language does not suggest a subjective test. Another subdivision of the very Section of the statute where the loss provision is found, permitted a debt deduction when "ascertained to be worthless and charged off

within the taxable year". (Section 23 (k), Revenue Act of 1936.) As hereinafter noted, even under that Section the courts have not agreed whether a purely subjective test was provided. But the contrast between the loss and the debt provisions has often been observed by the courts. Referring to the Revenue Act here involved, in *Rosenthal* v. *Helvering*, 124 F. 2d 474 (C. C. A. 2d), the court said (p. 476):

> The statute makes a distinction between the deduction of "losses" under § 23 (e) and (f), and of "bad debts" under § 23 (k). "Losses" must be deducted in the year in which they are "sustained" and if the taxpayer fails to learn of them in time, he loses the privilege; debts, on the other hand, must be deducted in the year in which the taxpayer "ascertains" them to be "worthless," and nobody understands that this imposes upon him the absolute risk of selecting the year when they actually become so.

To the same effect are *Commissioner* v. *MacDonald Eng. Co.*, 102 F. 2d 942, 944 (C. C. A. 7th); *Bartlett* v. *Commissioner*, 114 F. 2d 634, 638 (C. C. A. 4th); *San Joaquin Brick Co.* v. *Commissioner*, 130 F. 2d 220, 227 (C. C. A. 9th); *Rassieur* v. *Commissioner*, 129 F. 2d 820 (C. C. A. 8th).

Moreover, "these venerable requirements [of ascertainment of worthlessness by the taxpayer and charge off] had caused constant administra-

tive difficulties and a volume of litigation." (5 Mertens, Law of Federal Income Taxation (1945 Supp.), Sec. 30.27a (new), p. 170); besides, the cases were not in accord, some holding the year of ascertainment was that in which a prudent person would have considered the debt uncollectible; others holding that the proper year was that in which the taxpayer honestly ascertained the fact, no matter how much earlier a reasonably prudent person would have done so. *Rosenthal* v. *Helvering,* 124 F. 2d 474, 476 (C. C. A. 2d). To meet these difficulties, Congress, by Section 124 of the Revenue Act of 1942, c. 619, 56 Stat. 798 (26 U. S. C. Supp. IV, Sec. 23), amended the bad debt provision (Internal Revenue Code, Section 23 (k) (1)) to permit deduction of "debts which became worthless within the taxable year", retroactive as to taxable years beginning after December 31, 1938. Cf. *Cittadini* v. *Commissioner,* 139 F. 2d 29, 31 (C. C. A. 4th). Thereby, the standard of worthlessness in fact was substituted for the former ascertainment of worthlessness,[1] and the objective test long applied to loss deductions became also the rule for bad debts. The amendment was adopted in response to a suggestion

[1] The Ways and Means Committee Report, recommending the amendment, confirms this construction. H. Rep. No. 2333, 77th Cong., 1st Sess., p. 76 (1942–2 Cum. Bull. 372, 431):

"This section amends section 23 (k) of the Code to allow a deduction for a debt which becomes worthless during the taxable year regardless of the year in which the debt is ascertained to be worthless or charged off."

by the Treasury at the outset of the hearings on the 1942 bill,[8] and clearly expresses the intention to govern deductibility of bad debts and worthless stock losses by the same objective rule. To assure greater elasticity and equity in administration, a further amendment was at the same time proposed by the Treasury allowing a special seven year statute of limitations with respect to refund claims relating to deductions both on account of worthless stock losses and bad debts (in place of the former three year statute).[9] This sug-

[8] Statement of Randolph Paul, Hearings Before Ways and Means Committee, 77th Cong., 2d Sess., Revenue Revision of 1942, Vol. I, pp. 92–93:

"*Statute of limitations on bad debts and worthless stock losses.*—The difficulties surrounding the deduction for bad debts and worthless stock losses have long been familiar sources of irritation to taxpayers and the Commissioner alike. It is far from easy to ascertain when a debt is bad or when a share of stock becomes worthless. At the same time, the taxpayer must select the proper year before the statute of limitations has run with respect to that year.

"Much litigation is occasioned by the artificial barrier thus thrown up by the statute of limitations, as a taxpayer who chose one year only to be met with the claim that an earlier but barred year was the correct year must battle to defend his choice or lose the deduction entirely.

"It is believed that this useless litigation and many of the difficulties in this field can be avoided by, first, eliminating the ascertainment of worthlessness and the charge-off requirements in the case of bad debts—including securities producing capital losses—and, second, allowing a 7-year statute of limitations with respect to refund claims relating to a deduction on account of these items. Interest should not be allowed for the interval between the expiration of the normal statute of limitations and 6 months after the claim was filed."

[9] See fn. 8, *supra*.

gestion was also enacted into law and made applicable to taxable years beginning after December 31, 1937. (Revenue Act of 1942, Section 169, adding Section 322 (b) (5) to the Internal Revenue Code; and as amended by the Revenue Act of 1943, c. 63, 58 Stat. 26, Section 504.) Consequently, for the court below to have sustained taxpayer's contention would have frustrated the legislative scheme; the legislative history shows that Congress intends the loss to be taken in the year in which the stock actually became worthless, even though the taxpayer honestly believed the loss occurred in a different year.

True, taxpayer's appraisal is one of the factors to be considered in the ultimate determination of value or lack of value in a given tax year, and where a going business is concerned and there is "hope that a business although involved might be saved and value in the stock established" (*Forbes* v. *Commissioner*, 62 F. 2d 571, 574 (C. C. A. 4th)), it may become a factor of importance. Cf. *Coyle* v. *Commissioner*, 142 F. 2d 580, 582 (C. C. A. 7th): *Rassieur* v. *Commissioner*, 129 F. 2d 820, 827 (C. C. A. 9th). Here there is no going concern involved (R. 20). Moreover, in any event, taxpayer's "appraisal is but one of the factors to be considered", as said by the Circuit Court of Appeals for the Seventh Circuit in *Superior Coal Co.* v. *Commissioner*, 145 F. 2d 597, 598,

certiorari denied April 2, 1945, No. 950, last Term,[10] and (p. 599):

> To hold this basis as controlling when there are other factors relevant to the disputed question of value would amount to the substitution of our judgment for that of the Tax Court.

The "objective test" rather than the "subjective test" has generally been followed by the courts in cases of this character without making use of either phrase, but in the decision of the Fourth Circuit Court of Appeals in *Bartlett* v. *Commissioner,* 114 F. 2d 634, 638, 639 (C. C. A. 4th), where many such cases are collected, it was expressly stated that the time for the deduction of losses is fixed by a standard that is "purely objective." That decision was followed in *First Nat. Bank of Minneapolis* v. *United States,* 58 F. Supp. 425, 427 (D. Minn.).

Both the court below[11] (R. 80) and the Seventh Circuit Court of Appeals in the *Superior Coal Co.* case, 145 F. 2d. 597, 599, certiorari denied April 2, 1945, express disagreement with the holding of the Court of Appeals of the District of Columbia in *Smith* v. *Helvering,* 141 F. 2d 529 (decided by a divided court), relied upon by taxpayer, and

[10] Motion for leave to file petition for rehearing of petition for certiorari denied for want of jurisdiction, June 18, 1945.

[11] In *Beaudry* v. *Commissioner,* 150 F. 2d 20, the court below, citing the instant case, stated again its approval of the objective rather than subjective test as the basis for determining worthlessness of stock.

claimed in her application for certiorari in the instant case to conflict with the decision of the court below. In that case the question was whether shares of stock became worthless, as contended by taxpayer, in the year 1937 when formal dissolution occurred. The company was a closed corporation whose business was suspended in 1929 to the extent that thereafter it had no full time employees. However, after 1929 the corporation disposed of most of its equipment piecemeal and most of its business consisted of casual sales on orders received, and although insolvent it continued a bare existence through small sums paid into it each year by taxpayer. The court said (141 F. 2d at pp. 530, 531):

> The test applied by the Board was stated in the following terms: "The loss must be taken in the year in which it is sustained and at no other time and this means the year in which these shares in every substantial and realistic way become worthless." * * *
>
> * * * * *
>
> The test proposed by the Board in the present case is a highly objective one which disregards what the taxpayer may think of his investment, how much of an optimist he may be, or what he may consider to be the possibilities of future successful operation, or of eventual recoupment. An examination of the cases persuades us that the subjective appraisal of the taxpayer is of much greater importance.

However, the belief of taxpayer as to value is not necessarily the controlling element, and if the *Smith* case holds to the contrary, we submit that it was not correctly decided, both in this respect and also insofar as the Court of Appeals there assumed the function of the Tax Court in weighing the objective and subjective factors involved in the evidence. (See Point II, *infra.*)

The legal standard for which we contend is requisite for fair administration of a tax system based upon annual assessment. Neither the taxpayer nor the Government should be afforded opportunity to select the year in which deductions are taken. The former should not be permitted to save deductions for a year when income is heavy, nor the latter to confine them to a year when it is light. Temptation for evasion must increase if the taxpayer's belief constitutes the controlling factor in determination of year of loss, and difficulty of practical administration be magnified. These considerations of practical administration find added support in the legislative history and the prevailing view of judicial decision. Notwithstanding a taxpayer's honest belief to the contrary, the year for deduction of the loss must be the year in which, all factors being given due weight, events are such as to furnish convincing evidence to the trier of the facts that the stock has actually become worthless in that year.

II

THE FINDING OF THE TAX COURT THAT THE LOSS WAS NOT IN FACT SUSTAINED IN THE TAXABLE YEAR WAS CORRECTLY HELD BY THE COURT BELOW TO BE SUPPORTED BY SUBSTANTIAL EVIDENCE

The question whether particular corporate stock did or did not become worthless in a given taxable year is a pure question of fact. *Morton* v. *Commissioner,* 112 F. 2d 320 (C. C. A. 7th); *Commissioner* v. *Peterman,* 118 F. 2d 973 (C. C. A. 9th); *Coyle* v. *Commissioner,* 142 F. 2d 580 (C. C. A. 7th); *Superior Coal Co.* v. *Commissioner,* 145 F. 2d 597, certiorari denied April 2, 1945. Nor does the circumstance that the Tax Court here based its finding upon stipulated facts make that finding any the less a finding of fact or extend the range of appellate jurisdiction. Since the stipulated facts support the Tax Court's finding that the stock did not become worthless in the year 1937, the process of judicial review is at an end (*San Joaquin Brick Co.* v. *Commissioner,* 130 F. 2d 220, 224–225 (C. C. A. 9th), even though other conflicting inferences fairly may be drawn from the undisputed facts. *Commissioner* v. *Horseshoe Syndicate,* 110 F. 2d 748 (C. C. A. 5th). Contrary inferences and conclusions, even though deemed by the appellate court more reasonable or desirable and also supported by the evidence, are irrelevant so long as there is adequate support in the evidence for

what the Tax Court has inferred. *Commisioner* v. *Scottish American Co.*, 323 U. S. 119, 124, 125; *Dobson* v. *Commissioner*, 320 U. S. 489, rehearing denied, 321 U. S. 231; *Missouri-Kansas Pipe Line Co.* v. *Commissioner*, 148 F. 2d 460, 462 (C. C. A. 3d). The instant case falls precisely within the category recently described by this court in *Commissioner* v. *Scottish American Co.*, *supra* (p. 125) as exemplifying—

> one type of factual dispute where judicial abstinence should be pronounced. The decision as to the facts in this case, like analogous ones that preceded it, is of little value as precedent. The factual pattern is too decisive and too varied from case to case to warrant a great expenditure of appellate court energy on unravelling conflicting factual inferences. The skilled judgment of the Tax Court, which is the basic fact-finding and inference-making body, should thus be given wide range in such proceedings.[12]

Loss, like other deductions, is a matter of legislative grace, of statutory privilege not of right; it does not turn upon general equitable considerations, and only if there is clear provision therefor

[12] Compare the statement in 5 Mertens Law of Federal Income Taxation, Section 28.01, p. 92:

"The loss deduction provision has given rise to a terrific amount of litigation, as is demonstrated by the size of this chapter."

can any particular deduction be allowed. *New Colonial Co.* v. *Helvering,* 292 U. S. 435, 440; *Deputy* v. *duPont,* 308 U. S. 488, 493. Moreover, as this Court said in *Burnet* v. *Houston,* 283 U. S. 223, 227—

> The burden of proof to establish a deductible loss and the amount of it, clearly, was upon the respondent [taxpayer]. *Reinecke* v. *Spalding,* 280 U. S. 227, 233; *United States* v. *Anderson,* 269 U. S. 422, 443.

This includes the burden to establish the loss in the year in which the deduction is claimed. *Lambert* v. *Commissioner,* 108 F. 2d 624, 625 (C. C. A. 10th); *Keeney* v. *Commisioner,* 116 F. 2d 401, 403 (C. C. A. 2d).

Here the Tax Court specifically found the evidence not only (R. 67)—

> insufficient to establish that the stock had any value at the beginning of 1937 and became worthless during that year, it clearly shows that the stock was worthless prior to that year.

The record and the inferences, which the Tax Court was plainly justified in drawing from the record, surely contain ample support for this finding. As early as June 1932, Hartman admitted the allegations of the bill of complaint seeking to place it in receivership (R. 38) and thus conceded that the corporation's business had been and

was then being operated at great financial loss and that it was unable to meet and pay its obligations as they became due (R. 29). The company was forthwith placed in receivership and approximately a year later finally ceased operations (R. 20). As of that day, May 26, 1933, a new company (Hartman's, Inc.) purchased at a bankruptcy sale the assets of Hartman's principal subsidiary, Hartman Furniture & Carpet Company, for $501,000. The stock of the new company was issued to the subsidiary's creditors; stockholders of Hartman were merely given the right to subscribe for stock and debentures of the new company, a right which, however, taxpayer did not exercise.[13] (R. 20–21.)

The receivers' reports, approved by the district court, conclusively establish that Hartman was hopelessly insolvent and that its stock, subject to heavy claims of creditors, was worthless. The first report, approved on August 10, 1934, shows assets of only $39,543 in cash and liabilities consisting of outstanding claims aggregating more than $707,000 of which the receivers recommended that a total of $630,574 be allowed. The second report, filed on July 11, 1935, listed cash assets in the amount of $27,192 and claims of creditors in the same amount as the first report. A divi-

[13] Hartman Furniture & Carpet Company constituted the principal asset of Hartman (R. 26).

dend to creditors of only four percent was at that time recommended and approved and it does not appear that the creditors at any time received anything more out of this insolvent estate. The only other asset listed in these two receivers' reports was the Graham suit (see Statement, *supra*, pp. 4–6) for which apparently no value was stated. (R. 21.) After the Graham suit was settled and subsequently dismissed in May 1937 (R. 66), a final report was filed in September 1937, by the remaining receiver showing only $1,909 in assets and claims totaling $630,574 (R. 21–22). Accordingly, notwithstanding the settlement of the Graham suit, Hartman remained hopelessly insolvent, possessing assets of only nominal value, and the hundreds of thousands of dollars in claims of creditors remained unpaid.

Thus there was here a succession of "identifiable events," occurring many years before the taxable year of 1937, which taken separately or in combination, proved the stock to be completely worthless long before the taxable year and sustained the finding of the Tax Court. These included serious losses over a period of years, the receivership, the receivers' reports, the termination of operations, and the bankruptcy sale of the assets of the principal subsidiary. Similar events have often been held adequate to establish loss of all actual and potential value of stock in the tax-

able year in which they occurred. *DeLoss* v. *Commissioner*, 28 F. 2d 803 (C. C. A. 2d), certiorari denied, 279 U. S. 840; *Jeffery* v. *Commissioner*, 62 F. 2d 661 (C. C. A. 6th); *Industrial Rayon Corp.* v. *Commissioner*, 94 F. 2d 383 (C. C. A. 6th); *Lambert* v. *Commissioner*, 108 F. 2d 624 (C. C. A. 10th); *Bartlett* v. *Commissioner*, 114 F. 2d 634 (C. C. A. 4th); *Keeney* v. *Commissioner*, 116 F. 2d 401 (C. C. A. 2d); see also *Morton* v. *Commissioner*, 38 B. T. A. 1270, 1278–1279, affirmed, 112 F. 2d 320 (C. C. A. 7th) (cf. Br. 17–18, 27).

Despite taxpayer's assertions (see Br. 26, 29, 32), the Tax Court concluded that the evidence failed to establish that the Graham suit was of any substantial value[14] (R. 67). The merits of this suit were not shown, nor probability of recovery nor assurance of collection. The trier of the facts was justified in declining to infer from the stipulated fact—that the defend-

[14] Taxpayer relies (Br. 15–17) on *Louisville Trust Co.* v. *Glenn*, 33 F. Supp. 403 (W. D. Ky.), affirmed, 124 F. 2d 418 (C. C. A. 6th), but there, unlike the instant case, the trier of facts ruled that there was substantial hope of recoupment until the taxable year (in which the taxpayer received through a compromise settlement more than three-fourths what it claimed). The same is true of *Redfield* v. *Commissioner*, 34 B. T. A. 967 (cf. Br. 20–21, 27). *Russel Wheel & Foundry Co.* v. *Commissioner*, 3 B. T. A. 1168 (Br. 26, 28–29) did not involve worthless stock and the debtor was not insolvent.

ants were men of financial responsibility—that they possessed the means to satisfy the creditors' claims of more than $630,000, plus huge damages running into millions, a prerequisite in this derivative suit before any small stockholder [15] might look to substantial compensation for his loss. Certainly the stipulated fact did not compel the inference, and the refusal by the fact finder to make it was neither arbitrary nor unreasonable. On the showing made in this record, the Tax Court reasonably might infer that the value of the suit was not so substantial as to justify the taxpayer in postponing her loss deduction for approximately four years awaiting its outcome. All value had departed from the stock prior to 1937; what was left was at the most contested claims for damages against third parties for destruction of that value. The loss was certain; and a loss must be taken in the year in which it actually is sustained, even though it is "not possible to say beyond imaginable peradventure" (*De Loss* v. *Commissioner*, 28 F. 2d 803, 804 (C. C. A. 2d)) that at some vague future date an indefinite return on the investment is conceivable. *Young* v.

[15] Taxpayer's 1,100 Class A shares (R. 20) constituted less than two percent of the outstanding 60,000 Class A shares and less than one-third of one percent of the total outstanding stock with which she must share on liquidation (R. 25).

Commissioner, 123 F. 2d 597 (C. C. A. 2d);[16] *Clark* v. *Welch*, 140 F. 2d 271, 273 (C. C. A. 1st).

Morton v. *Commissioner*, 104 F. 2d 534 (C. C. A. 4th), cited by the taxpayer (Br. 26, 27–28), is, as the court below held (R. 79), inapplicable to the case at bar. There the court held that the loss of investment in real estate which was foreclosed in 1932 should be recognized as a deduction in 1934 when the litigation in connection with the property was compromised and finally settled. The court pointed out that the litigation subsequent to the foreclosure sale involved the validity of the sale itself and that until it was determined whether the sale was to stand or the property or its equivalent would be recovered by the taxpayer, nothing concerning the transaction had been settled, and therefore final settlement of the litigation was the determinative event which fixed the time of the loss in 1934. There was no question there of total worthlessness of property fixed and definite in a certain year prior to the taxable year, as here. Likewise, *Sabath* v. *Commissioner*, 100 F. 2d 569 (C. C. A. 7th), also relied upon by the taxpayer (Br. 27, 30–

[16] Taxpayer quotes (Br. 22) from the *Young* case and asserts that she complied with that case by claiming a loss for the "earliest year when it may possibly be allowed" and renewing "the claim in subsequent years if there is any reasonable chance of its being applicable to the income for those years." However, taxpayer made no claim of loss in 1932 or 1933, in which her loss appears to have been sustained (see Statement, *supra*, pp. 3–4, 6–7).

31), is, as the court below noted (R. 79), readily distinguishable on its facts. The only loss deduction permitted by the circuit court of appeals concerned the taxpayer's interest in an oil royalty trust; the company had abandoned its runs in the taxable year and had no substantial assets remaining over and above its liabilities.

The statute does not "require the taxpayer to be an incorrigible optimist" (*United States* v. *White Dental Co.*, 274 U. S. 398, 403), nor on the other hand permit him to gamble on the remote hope of such salvage as a claim incapable of rational appraisal may bring. As the Circuit Court of Appeals for the Fourth Circuit said in *Niagara Share Corp.* v. *Commissioner*, 82 F. 2d 208, 211:

> Such a course would result in endless confusion, not only in the accounts of taxpayers, but in the taxing department of the government.

The principle in both instances is the same; to permit the year in which the loss is deductible to rest upon nebulous, uncertain and technical factors is to invite manipulation in the choice of the tax year in which the deduction is taken, in contravention of the expressed Congressional intent. The courts have repeatedly sustained this construction and hold, with the court below, that despite possibility of recoupment, the year of actual loss is the proper year for the deduction, where probability of realization is merely speculative. Nor on the same reasoning, as the cases

also rule, is it material that such a possibility, incapable of rational appraisal at the time of the loss, later results in substantial recovery. *United States* v. *White Dental Co.*, 274 U. S. 398; *Commissioner* v. *Brown*, 54 F. 2d 563 (C. C. A. 1st), certiorari denied, 286 U. S. 556; *Commissioner* v. *Highway Trailer Co.*, 72 F. 2d 913 (C. C. A. 7th), certiorari denied, 293 U. S. 626, rehearing denied, 294 U. S. 731; *Commissioner* v. *John Thatcher & Son*, 76 F. 2d 900, 902 (C. C. A. 2d); *Niagara Share Corp.* v. *Commissioner*, 82 F. 2d 208 (C. C. A. 4th), *Cahn* v. *Commissioner*, 92 F. 2d 674 (C. C. A. 9th); *Hinrichs* v. *Helvering*, 95 F. 2d 117 (App. D. C.). As stated in *Niagara Share Corp.* v. *Commissioner, supra* (p. 211):

> It certainly seems the fairer course to pursue to allow a taxpayer to deduct a loss in the year when suffered and to pay a tax on the amount of the loss recovered, if any, in the year in which the recovery is made.

Moreover, whatever taxpayer recouped here obviously does not represent a recovery in the Graham suit. That action was primarily for the benefit of the corporation (R. 61); however, actually no money was paid to the corporation at all. If this were a settlement of the cause of action stated in the Graham suit (see R. 61), the $50,000 recovered would necessarily have been paid to the corporation's creditors; taxpayer and her co-plaintiffs would have received nothing. Again, under the

complaint of the Graham suit, any recovery by stockholders would be required to be divided among all the stockholders, of whom there were certainly many hundreds, and could not have been limited, as it was, to taxpayer and her eight co-plaintiffs.

Indeed, despite her present claim, taxpayer's own belief in the substantial value of the Graham suit is open to serious question. Her present claim is inconsistent with the loss deduction in the amount of $32,302 (disallowed by the Commissioner) which she asserted in her income tax return for the year 1934 on the basis of total worthlessness of this stock (R. 22). The Graham suit, commenced in 1932, must, at the time the 1934 return was filed, have been pending for at least two years. The Tax Court was entitled to weigh her present claim against her previous contradictory one and draw its own inferences as to the facts. Hence, even on the basis of the subjective appraisal, for which taxpayer urges (see Point I), the evidence is conflicting and the Tax Court surely could reasonably find against taxpayer.

Whether in a given case the likelihood of recoupment is real or, as here found, speculative, is peculiarly a fact question—for the drawing of inferences and the weighing of evidence,—varying with the circumstances of each case. Hence, since the test called for is "practical," not "legal" (*Lucas* v. *American Code Co.*, 280 U. S. at p. 449),

it is for application by the fact finder, and on substantial evidence the finder of facts has here found contrary to taxpayer's contention.[17]

CONCLUSION

The Circuit Court of Appeals correctly decided the issue before this Court on certiorari; its decision in this respect should be affirmed.

Respectfully submitted.

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OCTOBER 1945.

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[17] Cf. *Leiper* v. *Commissioner*, decided April 9, 1942 (1941–42 P-H B. T. A. Memorandum Decisions, par. 42,211), where in the case of another stockholder of Hartman a different member of the Board of Tax Appeals on weighing the evidence likewise found that its Class B stock became worthless prior to 1937 and sustained the Commissioner's denial of a loss deduction for 1937. Taxpayer relies on *Cooley Butler* v. *Commissioner*, 45 B. T. A. 593 (Br. 27, 29–30), but the Board pointed out in the *Leiper* case that the mine in the *Cooley Butler* case had a "demonstrated value" until the taxable year involved.

APPENDIX

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(e) *Losses by Individuals.*—In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

(1) if incurred in trade or business; or

(2) if incurred in any transaction entered into for profit, though not connected with the trade or business; or

(3) of property not connected with the trade or business, if the loss arises from fires, storms, shipwreck, or other casualty, or from theft. * * *

Treasury Regulations 94; promulgated under the Revenue Act of 1936:

ART. 23 (e)–1. *Losses by individuals.*—Losses sustained by individual citizens or residents of the United States and not compensated for by insurance or otherwise are fully deductible if (a) incurred in the taxpayer's trade or business, or (b) incurred in any transaction entered into for profit, or (c) arising from fires, storms, shipwreck, or other casualty, or theft, and a deduction therefor has not prior to the filing of the return been claimed for estate tax purposes in the estate tax return, or (d) if not prohibited or limited by any of the following sections of the Act: Section 23 (g), relating to wagering losses; section 24 (a) (6), relating to losses from sales or exchanges of property between members of a family or between a corporation and its shareholders;

section 112, relating to recognition of gain or loss upon sales or exchanges of property; section 117, relating to limitation on losses recognized by section 112 upon the sale or exchange of capital assets; section 118, relating to losses on wash sales of stock or securities; section 251, relating to income from sources within possessions of United States; and section 252, relating to citizens of possessions of United States. See section 213 as to limitation upon losses sustained by nonresident aliens.

In general losses for which an amount may be deducted from gross income must be evidenced by closed and completed transactions, fixed by identifiable events, bona fide and actually sustained during the taxable period for which allowed. Substance and not mere form will govern in determining deductible losses. Full consideration must be given to any salvage value and to any insurance or other compensation received in determining the amount of losses actually sustained. * * *

* * * * * *

ART. 23 (e)–4. *Shrinkage in value of stocks.*—A person possessing stock of a corporation can not deduct from gross income any amount claimed as a loss merely on account of shrinkage in value of such stock through fluctuation of the market or otherwise. The loss allowable in such cases is that actually suffered when the stock is disposed of. If stock of a corporation becomes worthless, its cost or other basis as determined and adjusted under section 113 is deductible by the owner for the taxable year in which the stock became worthless, provided a satisfactory showing is made of its worthlessness. * * *

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Supreme Court of the United States

OCTOBER TERM, 1945

No. 69

LILLIAN BOEHM,

Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

MOTION FOR LEAVE TO FILE A PETITION FOR REHEARING OUT OF TIME AND PETITION FOR REHEARING.

LOUIS BOEHM,
Attorney for Petitioner.

Supreme Court of the United States

OCTOBER TERM, 1945

No. 69

LILLIAN BOEHM,

Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

MOTION FOR LEAVE TO FILE A PETITION FOR REHEARING OUT OF TIME

TO THE HONORABLE, THE CHIEF JUSTICE AND THE ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

The undersigned, on behalf of the above named petitioner prays that the within motion for leave to file a petition for a rehearing out of time be granted in furtherance of the interests of substantial justice.

The within case was decided by this Court on November 13, 1945.

Pursuant to Rule 33 of the Rules of this Court petitioner's time within which to file a petition for rehearing expired on December 7, 1945. Neither petitioner nor the undersigned were aware of the provisions of Rule 33 and mistakenly believed that the time for filing a petition for rehearing was three months from the date of the decision.

It was not until December 13, 1945 that the undersigned learned for the first time of the provisions of Rule 33, and gave careful consideration to the opinion of this Court and concluded that the within petition for a rehearing should be submitted.

WHEREFORE, it is respectfully requested that the within motion for leave to file the annexed petition for re-hearing out of time should be granted.

Dated, New York, December 28, 1945.

LOUIS BOEHM,
Attorney for Petitioner.

Supreme Court of the United States

OCTOBER TERM, 1945

No. 69

LILLIAN BOEHM,

Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR REHEARING

Statement

TO THE HONORABLE, THE CHIEF JUSTICE AND THE ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

The undersigned, on behalf of the above named petitioner prays that a rehearing be granted of the above entitled case and that the decision of this Court be modified and the case remanded for further proceedings to the Tax Court of the United States in accordance with the opinion of this Court.

Facts

Petitioner was a stockholder of the Hartman Corporation. In December, 1932, together with other stockholders, she commenced a derivative stockholders' action against the

directors of the corporation for mismanagement and waste. In February, 1937, the action was compromised and settled. Petitioner received $12,500.00 pursuant to settlement. In her 1937 income tax return, petitioner claimed a deduction from gross income in the amount of $19,940.00, being the difference between the purchase price of the stock and the amount received under the settlement. The Commissioner denied the deduction. The Tax Court sustained his action and the Court below affirmed.

Decision of this Court

The decision of this Court (66 S. Ct. 125) was not based on the merits. It was predicated on the omission of certain evidence in the record which this Court deemed essential to establish the value of the suit which petitioner and others had brought against the Hartman directors. This Court stated in its opinion at 66 S. Ct., page 124:

> "While the stockholders' suit was prosecuted against defendants of admitted 'financial responsibility' and constituted an asset of the corporation until settled in 1937, the Tax Court felt that no substantial value to the suit had been shown. There was no evidence in the stipulation of the merits of the suit, the probability of recovery or any assurance of collection of an amount sufficient to pay the creditors' claim of more than $630,000 and to provide a sufficient surplus for stockholders so as to give any real value to their stock."

It is respectfully submitted that the Court should grant the within petition for a rehearing and remand the case to the Tax Court of the United States in order to enable petitioner to offer the evidence which this Court found to be lacking.

This case was submitted to the Tax Court upon a stipulation of facts. The stipulation provided "this stipulation shall be without prejudice to the right of either

party to introduce other and further evidence not inconsistent with the facts herein stipulated" (R., p. 20). No further evidence was offered by either party because counsel for both parties believed that the stipulation included all the facts necessary for a determination of the issues of this case on the merits (R., p. 17).

On October 23, 1943, the Tax Court decided this case against petitioner and in its opinion stated (R., p. 67):

> "We have no evidence on which to base a conclusion that the Graham suit was an asset of any substantial value. We know nothing of the merits of the suit, the probability of recovery, the assurance of the collection of a judgment, or other essential factors. The stipulated fact that the defendants were men of financial responsibility is not sufficient to establish the collectibility of a recovery equal to the outstanding claims."

On November 5, 1943, in compliance with the decision of the Tax Court that the stipulation was incomplete, petitioner filed a motion for a rehearing in the Tax Court to open the record for the presentation and submission of further evidence concerning the merits of the suit, the probability of recovery and the collectibility of a judgment (R., pp. 17-19). In support of said motion petitioner alleged as follows (R., p. 18):

> "Evidence will be offered on the rehearing to show that the recovery on the causes of action set forth in the complaint would far exceed the amount of outstanding claims of creditors, and would leave a substantial amount for the stockholders. Evidence will also be offered that the defendant directors in the Graham suit were able to respond to any judgment that might be rendered against them and that their net worth was many millions of dollars" (R. p. 18).

This motion was denied on November 8, 1943 (R. p. 2).

At the time that the stipulation of facts was prepared counsel for both parties were of the opinion that it set

forth all the essential facts to enable the Tax Court to decide this controversy *upon the merits.* Had they thought otherwise, they would have amplified the stipulation, or brought oral proof as to the matters the Tax Court deemed essential pursuant to the provisions of the stipulation quoted *supra.* This Court, the Circuit Court of Appeals and the Tax Court all based their decisions on the ground that the stipulation did not contain all the essential facts, and that, as the burden of proof was on the taxpayer, she had not sustained her burden. In other words, the decision of every court that has passed on this case was based not on the merits of the controversy, but upon the insufficiency of the stipulation to set forth all of the essential facts to enable a decision on the merits to be made.

This case was submitted to the Tax Court without oral argument. The first notice petitioner had that the Tax Court deemed the stipulation insufficient was after its decision had been rendered. There was no opportunity for discussion between Court and counsel such as ordinarily takes place on the trial of an action, and which would have enabled petitioner to supply the evidence which the trial judge deemed necessary to enable him to decide the case on the merits. Petitioner, therefore, had no opportunity to supply proof which the Court deemed essential on the trial of an issue of fact. Under such circumstances, we respectfully submit that the Tax Court should not only have granted, but should have welcomed, the motion to reopen the case so that it could have decided it upon the merits instead of on the alleged insufficiency of the stipulation.

In the application to the Tax Court to reopen this case, petitioner stated (R. p. 19):

> "Unless this further evidence is supplied on a rehearing, the decision in this case will not be upon the merits. The stipulation of facts was prepared for the convenience of the Court, and to eliminate the necessity of deciding factual issues concerning which there was no dispute. In endeavoring to expedite the admin-

istration of justice in this controversy, the parties inadvertently failed to supply evidence which this Court upon a careful study of the case deemed to be necessary to a proper determination of the issues on the merits. Petitioner should not be prejudiced by this inadvertent omission. Petitioner and her counsel believe that the further evidence will result in a decision of both issues on the merits, instead of a decision based upon the inadvertent omission of necessary facts in the stipulation. For that reason, the granting of the within motion will be in the interest of substantial justice."

We respectfully submit that the administration of justice is not advanced by having decisions based upon technicalities or inadvertent omissions or because the parties have inadvertently failed to include facts thought to be essential in a stipulation which both parties believed gave to the Court the essential facts for a decision on the merits. We respectfully submit that the Tax Court erred in refusing to reopen the case and that this honorable Court should exercise its supervisory power over the administration of the Federal Courts to rectify that error.

Petitioner argued before the Circuit Court of Appeals that the case should be remanded to the Tax Court for reopening and further proceedings. That Court, however, did not pass upon this request.

Petitioner respectfully submits that this Court should grant the within motion for a rehearing and remand the case to the Tax Court to enable petitioner to submit proof concerning these issues. Only by the presentation of this further evidence can an obvious injustice be avoided.

This Court itself recognized the injustice and hardship to petitioner saying at page 125, *supra:*

"The taxpayer points to the consequences of error and other difficulties confronting one who in good faith tries to choose the proper year in which to claim a deduction. But these difficulties are inherent under

the statute as now framed. Any desired remedy for such a situation, of course, lies with Congress rather than with the courts. It is beyond the judicial power to distort facts or to disregard legislative intent in order to provide equitable relief in a particular situation."

Congressional action may relieve future injustices but obviously cannot remedy the injustice to petitioner.

The injustice in the instant case has been the subject of considerable comment. (See article by Godfrey N. Nelson, in New York Times Financial Section, December 2, 1945, page 1, discussing the opinion of this Court in the instant case.)

We respectfully submit that the injustice resulting in the instant case can and should be remedied by remanding the case to the Tax Court and affording petitioner an opportunity of submitting the evidence which has been held to be lacking in the instant case in order to secure a determination on the merits.

Respectfully submitted,

LOUIS BOEHM,
Attorney for Petitioner.

SUPREME COURT OF THE UNITED STATES.

No. 69.—October Term, 1945.

Lillian Boehm, Petitioner, *vs.* Commissioner of Internal Revenue. } On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[November 13, 1945.]

Mr. Justice Murphy delivered the opinion of the Court.

We are met here with the problem of whether the Tax Court properly found that certain corporate stock did not become worthless in 1937, thereby precluding the petitioning taxpayer from claiming a deductible loss in that year under § 23(e) of the Revenue Act of 1936.[1]

The facts, which are stipulated, show that the taxpayer in 1929 bought 1,100 shares of Class A stock of the Hartman Corporation for $32,440. This corporation had been formed to acquire the capital stock of an Illinois corporation, and its affiliates, engaged in the business of selling furniture, carpets and household goods.

In April, 1932, the Hartman Corporation sent its stockholders a letter reporting that the current business depression had caused shrinkage of sales, decline in worth of assets[2] and unprecedented credit and corporate losses. Another letter sent the following month informed them that business had not shown any improvement although counteracting measures were being taken. Then on June 16, 1932, a federal court in Illinois appointed equity receivers upon the allegations of a creditor, which were admitted to be true by the Hartman Corporation, that the company had sustained large liquidating and operating losses from 1930 to 1932.[3]

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[1] 49 Stat. 1648, 1659; 26 U. S. C. § 23(e).

[2] The balance sheet as of December 31, 1931, which accompanied this letter, showed assets and liabilities of $15,401,097.97 and a total net worth of $9,410,659.50.

[3] The creditor's bill of complaint stated that Hartman Corporation and its subsidiaries in 1931 sustained losses of $701,648 from closing stores and losses of $1,150,000 from necessary liquidation. It was further alleged that

Subsequently, on December 16, 1932, a stockholders' derivative action, the so-called Graham suit, was instituted in a New York court against the Hartman Corporation and nine members of its board of directors, some of whom were also officers. This suit was brought by the taxpayer and eight others on behalf of themselves as stockholders[4] and on behalf of the corporation and all other stockholders who might join with them in the suit. The defendants were charged with waste, extravagance, mismanagement, neglect and fraudulent violation of their duties as officers and directors, "to the great damage, loss and prejudice of the Corporation and its stockholders." The plaintiffs sought (1) to compel the defendants to account to the corporation for their official conduct, (2) to compel the defendants to pay to the corporation's treasury the amount of loss resulting from their alleged wrongful acts, (3) to secure from the corporation suitable allowance for counsel fees and other costs incurred in the suit and (4) to secure such other relief as might be just, equitable and proper.

The Hartman Corporation ceased operations under the receivers on May 26, 1933, when a new company, Hartman's Inc., bought at a bankruptcy sale all of the assets of Hartman Corporation's subsidiary company for $501,000. The stock of the new company was issued to the subsidiary's creditors. Stockholders of Hartman Corporation were also given the right to subscribe to the stock and debentures of the new company, but the taxpayer did not exercise that right.

The receivers filed their first report in the federal court on August 10, 1934, in which it appeared that Hartman Corporation had outstanding claims of $707,430.67 and assets of only $39,593.13 in cash and the pending Graham suit. It does not appear whether the suit was listed as having any value. The identical situation was apparent in the second report, filed on July 11, 1935, except that the cash assets had fallen to $27,192.51. A 4% divi-

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the corporation sustained operating losses in 1930 in the amount of $1,830,000; in 1931, $2,076,266; from January, 1932, to June 16, 1932, $400,000. After stating that the company was being operated at a great financial loss and that it was unable to meet and pay its obligations, the bill concluded by alleging that the assets and properties were of great value and that if they were administered through a receivership they would be sufficient to pay all of the corporation's liabilities, leaving a surplus for the stockholders.

[4] These nine plaintiffs represented 4,407 of the approximately 60,000 Class A shares outstanding and 1/3 of the more than 335,000 Class B shares outstanding.

dend to creditors was also approved at that time. On September 30, 1937, the final report was made. Outstanding claims of $630,574.57 were then reported; the sole asset was cash in the amount of $1,909.94, which was then distributed to creditors after deduction of receivership costs.

In the meantime the Graham suit was slowly progressing. From 1933 to 1936, inclusive, extensive examinations were made of certain defendants, the plaintiffs expending some $2,800 in connection therewith exclusive of counsel fees. But the case never reached trial. On February 27, 1937, a settlement was consummated whereby the defendants paid the taxpayer and her eight co-plaintiffs the sum of $50,000 in full settlement and discharge of their claims and the cause of action. The taxpayer's share of the settlement, after payment of expenses, amounted to $12,500.

The taxpayer had tried unsuccessfully in her 1934 income tax return to claim a deduction from gross income in the amount of $32,302 as a loss due to the worthlessness of her 1,100 shares of stock. The Commissioner denied the deduction on the ground that the stock had not become worthless during 1934; apparently no appeal was taken from this determination. Then in 1937 the taxpayer claimed a deduction from gross income in the amount of $19,940, being the difference between the $32,440 purchase price of the stock and the $12,500 received pursuant to the settlement. The Commissioner again denied the deduction, this time on the ground that the stock had not become worthless during 1937. The Tax Court sustained his action and the court below affirmed as to this point.[5] 146 F. 2d 553. We granted certiorari because of an alleged inconsistency with *Smith* v. *Helvering*, 141 F. 2d 529 (App. D. C.), as to the proper test to be used in determining the year in which a deductible loss is sustained.

Section 23(e) of the Revenue Act of 1936, like its identical counterparts in many preceding Revenue Acts, provides that in computing net income for income tax purposes there shall be allowed as deductions "losses sustained during the taxable year and not compensated for by insurance or otherwise." Treasury regulations, in effect prior to and at the time of the adoption of the 1936

[5] The Commissioner also included in the taxpayer's 1937 gross income the $12,500 received in the settlement and the Tax Court sustained his action. But the court below reversed, holding that the $12,500 must be regarded as a capital item in reduction of loss rather than as income. This point is not now before us.

Act and repeated thereafter, have consistently interpreted § 23(e) to mean that deductible losses "must be evidenced by closed and completed transactions, fixed by identifiable events, bona fide and actually sustained during the taxable period for which allowed."[6] Such regulations, being "long continued without substantial change, applying to unamended or substantially reenacted statutes, are deemed to have received congressional approval and have the effect of law." *Helvering* v. *Winmill,* 305 U. S. 79, 83.

First. The taxpayer claims that a subjective rather than an objective test is to be employed in determining whether corporate stock became worthless during a particular year within the meaning of § 23(e). This subjective test is said to depend upon the taxpayer's reasonable and honest belief as to worthlessness, supported by the taxpayer's overt acts and conduct in connection therewith.

But the plain language of the statute and of the Treasury interpretations having the force of law repels the use of such a subjective factor as the controlling or sole criterion. Section 23(e) itself speaks of losses "sustained during the taxable year." The regulations in turn refer to losses "actually sustained during the taxable period," as fixed by "identifiable events."[7] Such unmistakable phraseology compels the conclusion that a loss, to be deductible under § 23(e), must have been sustained *in fact* during the taxable year. And a determination of whether a loss was in fact sustained in a particular year cannot fairly be made by confining the trier of facts to an examination of the taxpayer's beliefs and actions. Such an issue of necessity requires a practical approach, all pertinent facts and circumstances being open to inspection and consideration regardless of their objective or subjective nature. As this Court said in *Lucas* v. *American Code Co.*, 280 U. S. 445, 449, "no definite legal test is provided by the statute for the determination

[6] Treasury Regulations 94, Art. 23(e)-1, under the Revenue Act of 1936. Identical language is contained in Regulations 86, Art. 23(e)-1, under the Revenue Act of 1934; Regulations 101, Art. 23(e)-1, under the Revenue Act of 1938; Regulations 103, Sec. 19.23(e)-1, under the Internal Revenue Code; and Regulations 111, Sec. 29.23(e)-1, under the Internal Revenue Code.

[7] Treasury Regulations 94, Art. 23(e)-4, further makes clear that only losses in fact are deductible. Losses on stock due to shrinkage of value are allowable only to the extent "actually suffered when the stock is disposed of." And if, before being disposed of, the stock becomes worthless, its cost or other basis "is deductible by the owner for the taxable year in which the stock became worthless, provided a satisfactory showing is made of its worthlessness."

of the year in which the loss is to be deducted. The general requirement that losses be deducted in the year in which they are sustained calls for a practical, not a legal, test."

The standard for determining the year for deduction of a loss is thus a flexible, practical one, varying according to the circumstances of each case. The taxpayer's attitude and conduct are not to be ignored, but to codify them as the decisive factor in every case is to surround the clear language of § 23(e) and the Treasury interpretations with an atmosphere of unreality and to impose grave obstacles to efficient tax administration.

Second. The taxpayer contends that even under the practical, realistic test the stipulated facts demonstrate as a matter of law that the stock of the Hartman Corporation did not become worthless until 1937, when the stockholders' suit was settled. Hence it is claimed that the Tax Court erred in concluding that there was not a deductible loss in 1937 within the meaning of § 23(e).

But the question of whether particular corporate stock did or did not become worthless during a given taxable year is purely a question of fact to be determined in the first instance by the Tax Court, the basic fact-finding and inference-making body. The circumstance that the facts in a particular case may be stipulated or undisputed does not make this issue any less factual in nature. The Tax Court is entitled to draw whatever inferences and conclusions it deems reasonable from such facts. And an appellate court is limited, under familiar doctrines, to a consideration of whether the decision of the Tax Court is "in accordance with law." 26 U. S. C. § 1141(c)(1). If it is in accordance, it is immaterial that different inferences and conclusions might fairly be drawn from the undisputed facts. *Commiss[illegible] v. Scottish American Co.*, 323 U. S. 119.

Here it was the burden of the taxpayer to establish the fact that there was a deductible loss in 1937. *Burnet* v. *Houston*, 283 U. S. 223, 227. This burden was sought to be carried by means of the stipulation of facts. But the Tax Court, using the practical test previously discussed, found the stipulated facts "insufficient to establish that the stock had any value at the beginning of 1937 and became worthless during that year." It felt that such evidence "clearly shows that the stock was worthless prior to that year."

We are unable to say that the Tax Court's inferences and conclusions on this factual matter are so unreasonable from an evidentiary standpoint as to require a reversal of its judgment. The stipulation shows a succession of "identifiable events," occurring long before 1937, to justify the conclusion that the stock was worthless prior to the taxable year. The serious losses over a period of years, the receivership, the receivers' reports, the excess of liabilities over assets, the termination of operations and the bankruptcy sale of the assets of the principal subsidiary all lend credence to the Tax Court's judgment.[8] While the stockholders' suit was prosecuted against defendants of admitted "financial responsibility" and constituted an asset of the corporation until settled in 1937, the Tax Court felt that no substantial value to the suit had been shown. There was no evidence in the stipulation of the merits of the suit, the probability of recovery or any assurance of collection of an amount sufficient to pay the creditors' claims of more than $630,000 and to provide a sufficient surplus for stockholders so as to give any real value to their stock. The mere fact that the defendants were financially responsible does not necessarily inject any recognizable value into the suit from the stockholders' viewpoint. Hence it was reasonable to conclude that all value had departed from the stock prior to 1937 and that there was nothing left except a claim for damages against third parties for destruction of that value.

The taxpayer points to the consequences of error and other difficulties confronting one who in good faith tries to choose the proper year in which to claim a deduction. But these difficulties are inherent under the statute as now framed. Any desired remedy for such a situation, of course, lies with Congress rather than with the courts. It is beyond the judicial power to distort facts or to disregard legislative intent in order to provide equitable relief in a particular situation.

Affirmed.

Mr. Justice JACKSON took no part in the consideration or decision of this case.

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[8] See, in general, 5 Mertens, Law of Federal Income Taxation §§ 28.65 to 28.69; Lynch, "Losses Resulting From Stock Becoming Worthless—Deductibility Under Federal Income Tax Laws," 8 Fordham L. Rev. 199.